

No. 88-1400-CFX  
Status: GRANTED

Title: Franchise Tax Board of California, et al.,  
Petitioners  
v.  
Alcan Aluminium Limited, et al.

Docketed:

February 22, 1989

Court: United States Court of Appeals  
for the Seventh Circuit

Counsel for petitioner: Laddish, Timothy G.

Counsel for respondent: Salibra, II, Lawrence A., Carter, James  
Merle

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Entry	Date	Note	Proceedings and Orders
1	Feb 22 1989	G	Petition for writ of certiorari filed.
2	Mar 22 1989		Brief of respondent Imperial Chemical Inds., PLC in opposition filed.
3	Mar 22 1989		DISTRIBUTED. April 14, 1989
4	Mar 22 1989	G	Motion of Multistate Tax Commission for leave to file a brief as amicus curiae filed.
5	Mar 23 1989	X	Brief of respondent Alcan Aluminium in opposition filed.
6	Mar 23 1989		Brief amici curiae of New Jersey, et al. filed.
7	Mar 30 1989	X	Reply brief of petitioners Franchise Tax Board of CA, et al. filed.
8	Apr 17 1989		Motion of Multistate Tax Commission for leave to file a brief as amicus curiae GRANTED.
9	Apr 17 1989		Petition GRANTED. *****
10	Apr 28 1989		Record filed.
		*	Certified copy of original record on appeal received. (Box).
11	May 1 1989		Record filed.
		*	Certified copy of C. A. Proceedings received.
13	May 18 1989		Order extending time to file brief of petitioner on the merits until June 8, 1989.
14	Jun 8 1989		Brief amici curiae of Council of State Governments, et al. filed.
15	Jun 8 1989		Joint appendix filed.
16	Jun 8 1989		Brief of petitioners Franchise Tax Board of CA, et al. filed.
17	Jun 8 1989		Brief amicus curiae of Multistate Tax Commission filed.
18	Jun 8 1989		Brief amici curiae of Idaho, et al. filed.
26	Jun 29 1989		Record filed.
		*	Two volumes of certified pleadings received from the USDC of Illinois received.
19	Jul 8 1989		Brief amicus curiae of Shell Petroleum N.V. filed.
20	Jul 11 1989		Brief amicus curiae of Committee on State Taxation, etc. filed.
21	Jul 12 1989		Brief amici curiae of Member States of European Communities. et al. filed.
22	Jul 12 1989		Brief amicus curiae of Canada filed.
23	Jul 12 1989		Brief amici curiae of Union of Industrial and Employers'

2/14

Entry	Date	Note	Proceedings and Orders
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			Confed. of Europe, et al. filed.
24	Jul 12 1989		Brief amicus curiae of United Kingdom filed.
25	Jul 12 1989		Brief of respondent Imperial Chemical Industries PLC filed.
27	Jul 12 1989		Brief amicus curiae of Committee of London and Scottish Bankers filed.
28	Jul 12 1989		Brief of respondent Alcan Aluminium filed.
29	Jul 21 1989	G	Application (A89-67) to file a a reply brief in excess of page limits, submitted to Justice Stevens.
31	Jul 24 1989		Application (A89-67) granted by Justice Stevens, allowing a maximum of 30 pages.
30	Jul 27 1989		CIRCULATED.
32	Aug 9 1989	X	Reply brief of petitioners Franchise Tax Board of CA, et al. filed.
33	Aug 28 1989		SET FOR ARGUMENT WEDNESDAY, NOVEMBER 1, 1989. (3RD CASE)
34	Sep 6 1989	D	Motion of respondents for divided argument filed.
35	Oct 2 1989		Motion of respondents for divided argument DENIED.
36	Oct 18 1989	X	Supplemental brief of respondent filed.
37	Oct 18 1989	D	Motion of respondents for reconsideration of order denying motion for divided argument filed.
38	Oct 25 1989		Respondents' supplement to motion for reconsideration filed.
39	Oct 30 1989		Motion of respondents for reconsideration of order denying motion for divided argument DENIED. The request of respondents to submit the case on the briefs is denied.
40	Nov 1 1989		ARGUED.

**88-1400**  
No.

Supreme Court, U.S.

FILED

FEB 22 1989

JOSEPH F. SPANIOLO, JR.  
CLERK

# In the Supreme Court

OF THE

## United States

OCTOBER TERM, 1988

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA;  
LEONARD WILSON, Individually and as District Manager,  
Chicago Office of the Franchise Tax Board of the State of  
California; and B.M. RARANG, Individually and as Auditor,  
Chicago Office of the Franchise Tax Board of the State of  
California,

*Petitioners,*

VS.

ALCAN ALUMINIUM LIMITED AND IMPERIAL CHEMICAL  
INDUSTRIES PLC,

*Respondents.*

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### PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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**QUESTIONS PRESENTED**

1. Whether a foreign company which is the sole stockholder of an American subsidiary has standing to challenge in federal court the accounting method by which the State of California determines the locally taxable income of that subsidiary;
2. Whether, assuming that requisite standing exists in such an instance, a federal action for injunctive and declaratory relief is nevertheless barred by the Tax Injunction Act (28 U.S.C. § 1341) or the principle of comity which underlies the Act.

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No. \_\_\_\_\_

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FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA;  
LEONARD WILSON, Individually and as District Manager,  
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*Petitioners,*

VS.

ALCAN ALUMINIUM LIMITED AND IMPERIAL CHEMICAL  
INDUSTRIES PLC,

*Respondents.*

### **PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT**

Petitioners Franchise Tax Board of the State of California, et al., respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit, entered on October 19, 1988.

### **OPINIONS BELOW**

The decision of the United States Court of Appeals for the Seventh Circuit is reported at 860 F.2d 688, and is reprinted in the Appendix at pages A1-A20. The unpublished Memorandum Opinion of the United States District Court for the Northern District of Illinois, Eastern Division, is reprinted in the Appendix at pages A21-A27.

## JURISDICTION

The judgment of the Court of Appeals for the Seventh Circuit was entered on October 19, 1988. A timely petition for rehearing, with suggestion that rehearing be held en banc, was denied on January 9, 1989. On January 24, 1989, the Court of Appeals granted petitioners' motion for a stay of the issuance of the mandate for a period of 30 days to enable petitioners to file the present petition. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

## STATUTORY PROVISIONS INVOLVED

### 28 U.S.C. § 1341:

"The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."

## STATEMENT OF THE CASE

The consolidated actions that are the subject of this petition were brought by two foreign corporations seeking to challenge, by way of declaratory and injunctive relief, the unitary business/formula apportionment method of accounting under which the Franchise Tax Board of the State of California has proposed to determine the taxable income of the foreign companies' American subsidiaries properly allocable to California.<sup>1</sup> The two suits

<sup>1</sup> In *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983), this Court upheld the constitutionality of California's method of taxation as applied to a domestic company with foreign subsidiaries, rejecting the contention that California was required to determine the locally taxable income of that company under the separate accounting/arm's length method of taxation used by the Federal Government and various foreign jurisdictions. However, the Court specifically left open the question whether the unitary business/formula apportionment method of accounting is constitutionally permissible when the taxpayer is a domestic subsidiary of a foreign parent. See 463 U.S., at 189, n. 26. The basic distinction between the unitary business/formula apportionment method

were filed in the Northern District of Illinois, with jurisdiction over the subject matter being based on 28 U.S.C. §§ 1331, 1337, 1343 and 2201. Named defendants in one suit are the Franchise Tax Board and two employees assigned to its Chicago office; in the other, the Franchise Tax Board and a single Chicago employee. Said party-defendants are hereinafter collectively referred to as "the Board."

Plaintiffs-respondents, both of which claim that California's method of taxation violates the Foreign Commerce Clause, are Alcan Aluminium Ltd. ("Alcan") and Imperial Chemical Industries PLC ("Imperial"). Alcan, a Canadian company, is the indirect parent of Alcan Aluminum Corporation ("Alcancorp"), a company organized under the laws of Ohio. Imperial, a British company, is the indirect parent of ICI Americas, Inc. ("Americas"), a company organized under the laws of Delaware. Although Alcancorp and Americas are the corporate taxpayers involved here, neither is a party to either lawsuit.

During the years in question, the two American subsidiaries, Alcancorp and Americas, conducted business in California and were therefore subject to the state's corporate tax laws. The Board has determined, or is in the process of determining, the tax liability of these companies under the unitary business/formula apportionment method of accounting. Neither respondent has contested the Board's findings that their respective subsidiaries were engaged in unitary enterprises with their parent companies and other subsidiaries of the parents. Alcan Stip., "Issues," at 2; Imperial Stip., ¶ 30a.<sup>2</sup> Both contend, however, that California's method of taxation imposes an unconstitutional burden on the conduct of their (the parents') foreign commerce. In particular,

of accounting and separate geographical accounting is discussed in the *Container* opinion at pages 164-165.

<sup>2</sup> Stipulations of fact, with voluminous exhibits attached, were filed in the District Court in anticipation of the legal issues in the two cases being resolved through cross-motions for summary judgment. Thus, there is a comprehensive factual record in both cases, in contrast to the typical situation in which a court is called upon to decide a question of standing solely or largely on the pleadings.

both have urged that the combined apportionment method of accounting utilized by California results in double taxation of their income and requires that they assume costly compliance burdens.<sup>3</sup>

The audits with respect to AlcanCorp that are either completed or underway cover the years 1965 through 1974 and 1976 through 1981. For the years through 1978, the Board has calculated AlcanCorp's tax liability on an apportioned share of the total business income of the unitary enterprise of which it is a part. AlcanCorp has paid the taxes so calculated for the years 1965 through 1974 and has pursued its administrative remedies with the Board. Alcan Stip., ¶ 36. It has also filed two actions for refund of these taxes in the California courts. *Ibid.*; Exhs. XIX-1 and 2. These actions are still pending. *Ibid.*

The Board has also recomputed Americas' net income subject to California tax for income years ending 1972 through 1981, using as the apportionment base the worldwide income of the unitary enterprise headed by Imperial. Imperial Stip., ¶¶ 10, 14. Americas has paid the resulting assessments for 1972-1975, and has timely filed claims for refund with the Board. Imperial Stip., ¶ 29. The company has also filed a protest of the proposed assessment, calculated on the same basis, for years 1976 through 1981. *Ibid.*

During the audit process, the Board has not directed any correspondence to Alcan or Imperial or to any other group companies not doing business in California. Alcan Stip., ¶ 52; Imperial Stip., ¶ 27. All taxes assessed or proposed to be assessed

<sup>3</sup> The claim of double taxation is based on the fact that the income of the foreign parents and their foreign subsidiaries is included in the preapportioned tax base. Addressing a similar claim, this Court recently stated: "But income that is included in the preapportionment tax base is not, by virtue of that inclusion, taxed by the State. . . . As our Commerce Clause analysis of apportionment formulas has made clear, the inclusion of income in the preapportionment tax base of a state apportionment formula does not amount to extraterritorial taxation." *Shell Oil Company v. Iowa Dept. of Revenue*. \_\_\_\_ U.S. \_\_\_\_, 109 S.Ct. 278, 284, 102 L.Ed.2d 186, 199 (1988).

by the Board are against AlcanCorp and Americas. *Ibid.* The Board has not assessed or proposed to assess taxes against either Alcan or Imperial. *Ibid.*

Upon institution of the lawsuits by Alcan and Imperial, the Board filed motions to dismiss, asserting, inter alia, that the respective plaintiffs lacked standing to challenge the state tax treatment of their domestic subsidiaries. The District Court initially ruled in plaintiffs' favor on the standing question. Thereafter, each of the parties moved for summary judgment, with the Board again urging that requisite standing was lacking. On reconsideration of the standing question, the District Court held that respondents were subject to the general rule prohibiting shareholder suits to redress corporate injuries. More specifically, the District Court rejected respondents' claims that they suffer injuries distinct from those of their subsidiaries because California's method of taxation allegedly results in double taxation of their income and requires that they bear a substantial portion of the compliance costs. The District Court accordingly ordered the dismissal of both actions. App., at A27.

Respondents appealed to the Seventh Circuit Court of Appeals, which reversed the order of dismissal and remanded the matter for further proceedings. The Court of Appeals first stated that cases applying the shareholder standing rule fall into two categories: (1) those which bar standing to avoid the manipulation of diversity jurisdiction or a threatened interference with corporate management, and hence "are animated by concerns about the limits on judicial power and the appropriateness of a particular plaintiff bringing a particular action," and (2) those which bar standing to avoid a multiplicity of suits, and hence are animated by the mere "housekeeping concerns" of the federal judiciary. App., at A10-A11. The Court then concluded that a denial of standing in the present cases would serve only the latter objectives, and, implicitly, that standing requirements are less stringent in this category of cases. See, e.g., App., at A11 ("... in addressing whether injuries to foreign parents are sufficiently direct to confer standing, we attend to which of the several aims of the shareholder standing 'rule' would be served by its invocation"). While apparently agreeing with the District Court that the alleged

compliance costs and double taxation of income would not constitute direct injuries to the parent companies, see App., at A13-A14, the Court went on to find a "direct and independent injury" that had escaped even the attention of respondents. The Court of Appeals held that from the standpoint of foreign companies the unitary business/formula apportionment method of accounting employed by California diminishes the attractiveness of owning American subsidiaries as compared to conducting foreign commerce through contracts with independent companies; that the accounting method therefore burdens foreign companies' decisions to conduct foreign commerce through American subsidiaries; and that this burden on the decision-making of foreign companies is a direct and independent injury sufficient for standing purposes. App., at A15-A17.

Turning next to the proscriptions of the Tax Injunction Act (28 U.S.C. § 1341), the Court of Appeals deemed the Act to be inapplicable to the suits filed by Alcan and Imperial for declaratory and injunctive relief, stating that "the Act has not been construed so broadly as to bar a nontaxpayer (like the parent companies involved here) who lacks a remedy in state court from bringing suit in federal court on the ground that an affiliated taxpayer possesses adequate state court remedies." App., at A18. The Court then considered the principle of comity underlying the Act. It stated that the Act "left intact federal courts' discretionary power to grant or withhold relief so as to avoid needless obstruction of the domestic policy of the states," and that, in some circumstances, "this discretion, guided by considerations of comity and federalism, may be exercised to bar suits against state tax assessments to which the Tax Injunction Act is inapplicable." App., at A18. It held, however, that "comity and federalism, weighty as these concerns are where the federal courts pass on the constitutionality of state tax legislation, cannot justify withholding federal jurisdiction from a party with no cause of action in state court to redress its own direct and independent injury." App., at A19.

## REASONS FOR GRANTING THE WRIT

### I

#### THE COURT OF APPEALS' DECISION ON THE STANDING ISSUE CONFLICTS WITH DECISIONS IN TWO OTHER CIRCUITS

The question whether a foreign company has standing in federal court to challenge the state tax treatment of a domestic subsidiary has been addressed in three previous cases, each of which ruled adversely to the foreign company-stockholder. Two of the decisions were rendered by the Ninth Circuit Court of Appeals: *Shell Petroleum, N.V. v. Graves*, 709 F. 2d 593 (9th Cir. 1983), cert. den., 464 U.S. 1012 (1983), and *EMI Ltd. v. Bennett*, 738 F. 2d 994 (9th Cir. 1984), cert. den., 469 U.S. 1073 (1984). The Court of Appeals in the present matter has virtually conceded that its opinion, which holds that Alcan and Imperial have the requisite standing to pursue such an action, is in conflict with these decisions. See App., at A1 and A17, n. 12.

In addition, however, opposite results were reached in a decision of the District Court of the Southern District of New York that was summarily affirmed by the Second Circuit Court of Appeals: *Alcan Aluminum Ltd. v. Franchise Tax Board*, 558 F. Supp. 624 (S.D.N.Y. 1983), aff'd mem., 742 F. 2d 1430 (2d Cir. 1983), cert. den., 464 U.S. 1041 (1984). While the Second Circuit did not write a full-dress opinion, its summary order affirming the district court opinion stated: "We find appellant's contentions without merit and affirm for substantially the reasons stated in the opinion of the district court reported at 558 F. Supp. 624." The order is reproduced in the Appendix at pages A28-A29.<sup>4</sup>

<sup>4</sup> The order includes the following footnote: "Since this statement does not constitute a formal opinion of this court and is not uniformly available to all parties, it shall not be reported, cited or otherwise used in unrelated cases before this or any other court." The quotation of the order in the present matter does not fall within that admonition. The order has been available to all parties in the present lawsuits. It was issued in an action brought by Alcan, one of the present plaintiffs, who at that time was represented by Sidley & Austin, a law firm which has

The Foreign Commerce Clause claims in each of the previous cases were substantially identical to the claims advanced by Alcan and Imperial in the present cases. Indeed, as already indicated, one of the previous cases was an unsuccessful attempt by Alcan to obtain the same relief against the Board that it now seeks in the federal court in Illinois.

## II

### THE COURT OF APPEALS' DECISION CREATES A BASELESS EXCEPTION TO TRADITIONAL STANDING RULES THAT WILL RESULT IN UNPRECEDENTED FEDERAL INTRUSION IN STATE TAX MATTERS

#### A. Contrary to the decision of the Court of Appeals, the issue of stockholder standing in state tax matters does not implicate mere "housekeeping concerns" of the federal judiciary

This Court has long recognized "the important and sensitive nature of state tax systems and the need for federal court restraint when deciding cases that affect such systems." *Fair Assessment in Real Estate v. McNary*, 454 U.S. 100, 102 (1981). Thus, even prior to the enactment of the Tax Injunction Act (28 U.S.C. § 1341), the Court espoused a principle of equitable restraint in state tax matters. As it explained in *Matthews v. Rodgers*, 284 U.S. 521, 525 (1934):

"The reason for this guiding principle is of peculiar force in cases where the suit . . . is brought to enjoin the collection of a state tax in courts of a different, though paramount sovereignty. The scrupulous regard for the rightful independence of state governments which should at all times actuate the federal courts, and a proper reluctance to interfere by injunction with their fiscal operations, require that such relief

appeared on behalf of both Alcan and Imperial in this proceeding. Furthermore, the New York case was not "unrelated" to the present matter since Alcan sought in that case to do precisely what it has sought to do here: challenge California's unitary tax treatment of its domestic subsidiary. The Board raised the issue of collateral estoppel before the District Court in Illinois, but that issue was never reached by the court. Consequently, the Board did not address the issue of collateral estoppel in the appeal before the Seventh Circuit.

should be denied in every case where the asserted federal right may be preserved without it."

The Tax Injunction Act reinforces this principle of noninterference with state tax administration, but does not supplant it. On the contrary, this Court has held that the principle of comity underlying the Act is so compelling as to preclude federal intrusion in state tax matters even in situations not specifically covered by the Act. See *Fair Assessment in Real Estate v. McNary*, *supra*. (holding that the principle of comity precludes a suit for monetary damages under 42 U.S.C. § 1983); see also *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293 (1943).

The Court of Appeals' whole approach to the standing issue in the present matter is inconsistent with this line of authority. When addressing the issue of standing, the Court disregards the fact these stockholder suits seek declaratory and injunctive relief against state taxing authorities. Instead the Court says that since the suits do not involve a manipulation of diversity jurisdiction or a threat to corporate management, the stockholders' standing only implicates the Court's "housekeeping concerns," as opposed to "concerns about the limits on judicial power and the appropriateness of a particular plaintiff bringing a particular action." App., at A10-A11. Only *after* the Court concludes that the Board has invoked the stockholder standing rule in an area "where its underpinnings are weakest" (App., at A17), and only *after* the Court concludes that "housekeeping concerns" do not warrant a denial of standing, does the Court proceed to recognize "that 'the principle of comity militates in favor of a stringent standard of justiciability in cases that threaten to interfere with state taxes.'" App., at A19. The Board submits that this is a backward approach to the standing issue which is clearly erroneous. A shareholder's suit brought to challenge state taxation of a corporate taxpayer belongs at the top of the Court of Appeals' totem pole, not at the bottom.

Furthermore, the Court of Appeals' analysis of the stockholder standing rule is historically inaccurate. Even the so-called "traditional limitations on shareholder standing" which the Court places at the top of its totem pole cannot properly be characterized as merely "judge-made restrictions on the availability of the

federal courts." App., at A10. As is evident from this Court's decision in *Hawes v. City of Oakland*, 104 U.S. 450 (1881), a case cited by the Court of Appeals, the rule goes back to the English common law and is based on the fact that a corporation is an entity separate from its stockholders. *Id.*, at 455. The *Hawes* case itself does not represent an application of the stockholder rule as such. Rather, the Court in that case was concerned with the misuse of an *exception* to the stockholder rule, namely, the maintenance in equity of so-called derivative suits. The Court was particularly concerned with increasingly common situations in which corporations, "instead of resorting to the State courts, which are their natural, their lawful, and their appropriate forum" (*id.*, at 452), would collude with an out-of-state stockholder in order to satisfy the requirements of diversity jurisdiction where a federal action was not otherwise available. *Id.*, at 452-453. See also *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 529-533 (1983).

The Court of Appeals has missed the parallelism between a collusive suit brought by one of several stockholders to enable a corporation to obtain access to a federal forum, and a suit brought by a sole stockholder of a corporation to accomplish the same objective. Due to the proscriptions of the Tax Injunction Act, neither of the actual taxpayers in the present matter can seek declaratory and injunctive relief against the California tax assessments in federal court. At the same time, though the Court of Appeals is reluctant to concede the point (see App., at A4-A5), it should be evident that the actual taxpayers can voice any and all Foreign Commerce Clause objections to the tax assessments in the state courts. Under these circumstances, the federal suits brought in the names of the sole stockholders serve no purpose other than to provide the corporate taxpayers with a federal forum—a forum to which they would otherwise not be entitled.

**B. The Court of Appeals has given no valid basis for concluding that the stockholders involved here suffer direct injuries that are independent of those to the corporate taxpayers**

**1. The Court's conclusion that the unitary method of taxation burdens the decision-making of foreign companies is based on false premises**

The stockholder standing rule cannot be avoided by an allegation of injuries to the stockholder that are the indirect result of wrongs against the corporation. *Pittsburgh & W.Va. Ry. v. U.S.*, 281 U.S. 479, 486-487 (1930). However, as the Court of Appeals has properly recognized, a stockholder may bring an individual action when he is injured directly and independently of the corporation, or, as one court has stated, "where the wrong itself amounts to a breach of duty owed to the stockholder personally." *Schaffer v. Universal Rundle Corporation*, 397 F.2d 893, 896 (5th Cir. 1968).<sup>5</sup>

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<sup>5</sup> The Court of Appeals states in its opinion that "The FTB does not seriously contest plaintiffs' claims that their interest in challenging the California franchise tax satisfies the case or controversy requirement." App., at A5. On the contrary the Board has never accepted the proposition that a shareholder seeking to redress a corporate injury has standing in the constitutional sense. Article III "requires the party who invokes the Court's authority to 'show that he *personally* has suffered some actual or threatened injury . . ." *Valley Forge College v. Americans United*, 454 U.S. 464, 472 (1982); emphasis added. The legal basis for the general rule that only a corporation and not its shareholders can complain of an injury or wrong done to the corporation is that a stockholder is not personally injured by a wrong done to the corporation; his rights are derivative. *Pittsburgh & Va. Ry. v. U.S.*, 281 U.S. 479, 487 (1930). Thus, although the cases dealing with stockholder standing constitute a line of authority separate from that dealing with standing under Article III, it remains open to question whether a sole or controlling shareholder's ownership interest in a corporation is sufficient by itself (see App., at A5-A6) to satisfy the "injury in fact" requirement of Article III. In any event, even if the "injury in fact" requirement is satisfied, it is clear that such a shareholder may still pursue an individual action only upon the showing of a direct injury which is independent of any injury to the corporation.

In the lower courts, respondents argued that the requirement of a direct and independent injury was satisfied by their allegations that the application of California's unitary method of taxation to their domestic subsidiaries results in double taxation of the parents' income (as well as other income in which the parents have an interest) and requires them to bear substantial compliance costs. As previously noted, the Court of Appeals did not accept this argument. It did, however, discover another "injury" that was not even suggested by respondents: a burden on the foreign companies' decisions to conduct business through American subsidiaries due to the unitary method's potential "to penalize foreign ownership of American assets." App. at 15.<sup>6</sup>

Stated in the form of a syllogism, the Court of Appeals' reasoning appears to be as follows:

#### MAJOR PREMISE

Foreign companies seeking to sell or purchase products or services in California choose between conducting business through dealings with American subsidiaries or through contracts with unrelated companies.

#### MINOR PREMISE

When such companies choose to operate through American subsidiaries, and they conduct foreign operations at less cost than in California, a higher proportion of the unitary business' worldwide earnings will be attributed to California than would be the case if the foreign companies engaged in precisely the same foreign commerce through arm's length contracts with unaffiliated companies.<sup>7</sup>

<sup>6</sup> Not only did the respondents fail to raise this argument, but Alcan suggested the reverse: that the unitary method "as applied to foreign parents [sic] has penalized *foreign* activities which increase productivity or develop cheap and abundant resources." Brief of Appellant (Alcan Aluminium Limited), at 36; emphasis added.

<sup>7</sup> This minor premise is drawn from the discussion which appears at pages 16-17 of the Slip Opinion. App., at A15-A16. At page 16, the

#### CONCLUSION

Therefore, the unitary tax diminishes the attractiveness of owning American subsidiaries in comparison with entering into contracts with independent companies, creating a burden on foreign companies' decisions to conduct business through American subsidiaries.

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The major premise of this syllogism is incomplete insofar as it ignores the fact that foreign companies desiring to conduct business in the United States have a third choice: the conduct of business through branch operations. See, e.g., *Bass, etc., Ltd. v. Tax Comm.*, 266 U.S. 271 (1924) (upholding use of formula apportionment to determine locally taxable income of United Kingdom corporation with branch operations in New York).

The minor premise is so faulty as to destroy the validity of the conclusion. First, the Court of Appeals has erroneously assumed that if a foreign company does business in California through "arm's length contracts with unaffiliated companies," it will have taxable income determinable on a separate accounting basis rather than under the unitary method. Second, the Court has gratuitously assumed (erroneously, the Board believes) that it would be possible for a foreign company to conduct "precisely the

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Court states that, "*These companies* will show a higher taxable income in California under the unitary tax scheme than *they* would [show] if *they* engaged in precisely the same foreign commerce through arm's length contracts with unaffiliated companies." App., at A15. (Emphasis added.) It is therefore evident that the term "[t]hese companies" refers to the foreign parent companies. However, the actual taxpayers in such an instance would be the American subsidiaries operating in California, not their foreign parents. In other words, contrary to what the Court's statement seems to imply, the foreign parents would not "show" any "taxable income in California . . ." Elsewhere (at n. 10) the Court refers to "the proportion of worldwide earnings attributed to California operations." For the sake of accuracy, it is this terminology which has been incorporated in the statement of the minor premise.

same foreign commerce" through an independent contractor as through an American subsidiary.

With respect to the first assumption, the Court speaks in terms of the unitary method attributing to California "a higher taxable income" or a higher "proportion . . . of worldwide earnings" than would be attributed to California if a foreign company conducted its commerce through unaffiliated companies. Thus, the Court clearly is under the impression that *some* taxable income of the worldwide unitary business, as opposed to a zero amount of income, would be attributed to the state in the latter instance. In fact, whether the parent dealt directly with the unaffiliated company or had its American subsidiary do so, if only the unaffiliated company and not the parent or its subsidiary were doing any business in California, California would attribute *none* of the worldwide unitary business income to California because neither the parent nor the subsidiary would be a taxpayer under California tax law.

If, on the other hand, the activities of a foreign company engaged in a unitary business were such as to give rise to *any* tax liability in California, that liability would be determined by use of unitary formula apportionment regardless of the form in which the foreign company chose to conduct its foreign commerce. If the foreign company operated through an American subsidiary, the taxable income of the subsidiary would be determined under the unitary apportionment method. If the foreign company operated through a branch in California, the taxable income of the foreign company would be determined under the unitary apportionment method. And, finally, if the foreign company operated through an unaffiliated corporation in such a way as to give rise to *any* tax liability on the part of the foreign company, that liability would be determined under the unitary apportionment method, whether or not its relations with the unaffiliated company were deemed to be at "arm's length."<sup>8</sup> Given these circumstances, the

<sup>8</sup> In its reply to the Board's petition for rehearing in the Court of Appeals, Alcan took this to mean that the Board asserts "it can combine for unitary tax purposes two companies that are unaffiliated and are dealing at arms [sic] length." Reply to Petition for Rehearing (Alcan

unitary method cannot be viewed as a burden on the foreign company's decision to conduct foreign commerce in one form or another. The unitary method will be used to determine taxable income attributable to California regardless of the form chosen.

In holding that respondents have requisite standing in this matter, the Court of Appeals has also assumed that foreign companies such as Alcan and Imperial have the option of conducting "precisely the same foreign commerce" through either American subsidiaries or independent contractors. This is difficult to imagine. California has not been a mere market place for the goods produced by the multinational enterprises headed by Alcan and Imperial. The principal activity of Alcan's subsidiary in California during all but one of the 14 years covered by the challenged tax assessments (1965-1978) consisted of the operation of a large manufacturing facility. Alcan Stip., ¶ 6. Similarly, Imperial's subsidiary operates manufacturing and research facilities in California. Imperial Stip., ¶ 8. It is inconceivable that either Alcan or Imperial could conduct "precisely the same foreign commerce" through unaffiliated companies.

Once again, therefore, it is unrealistic for the Court of Appeals to conclude that California's use of the unitary method of taxation in the present case "diminishes the attractiveness of owning American subsidiaries in comparison with entering into contracts with independent companies as a means of engaging in foreign commerce." App., at A15. Such a comparative situation does not exist here. In order to participate in the American economy to the extent they do, Alcan and Imperial must operate either through

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Aluminium Limited), at 1-2. That, of course, is incorrect. The point is simply this: If a foreign company engaged in a unitary enterprise were doing business in California through an unaffiliated company in such a manner as to give rise to *any* tax liability on the part of the foreign company, the unitary character of the business would require that the foreign company's tax liability be determined on a formula apportionment basis. This would entail a combined report of only the operations carried on by the *unitary* enterprise within and without the state, not a combined report of the unitary operations and the independent operations of the unaffiliated company.

American subsidiaries or branch operations.<sup>9</sup> What they insist, however, is that the income attributed to the California activities should be determined under the separate accounting/arm's length method of taxation. They have pitted this accounting method against the unitary method, not the use of American subsidiaries against the use of independent contractors.

**2. Even if the foreign parents were faced with the choice envisioned by the Court, such a "burden" on their decision-making would not constitute a cognizable injury for standing purposes**

As indicated above, the Court of Appeals has apparently assumed that if a foreign company which is part of a unitary business were to engage in commerce in California through contracts with an unaffiliated company, at least some of the income of the unitary business would be attributed to California. Thus, the Court has not gone so far as to suggest that since a foreign company might be able to devise a way to conduct its foreign commerce through an unaffiliated company totally free of California taxes, the imposition of *any* tax against its American subsidiary is such a burden on a foreign company's decision-making as to constitute a sufficient cognizable "injury" to give that foreign company standing to challenge *any* California tax in the federal courts. It has stopped just short of that, however.

The Court of Appeals has held, in effect, that, everything else being equal, a foreign company should not be forced by state tax considerations to select one form of doing business over another. In other words, its underlying thesis seems to be that the potential tax liability arising from the conduct of foreign commerce should be the same, regardless of the form in which the commerce is conducted. It is a fact of life, however, that tax consequences often vary, depending upon the form of doing business, the form of a particular business transaction, etc.

<sup>9</sup> This was explicitly recognized by Imperial in its opening brief in the Court of Appeals, in which it stated: "Without the existence of Americas, Imperial's considerable commerce with the United States could not exist." Brief of Plaintiff-Appellant Imperial Chemical Industries PLC, at 21.

It is difficult to understand how the resulting "burden" on a company's decision-making can be regarded as a cognizable injury. In the present case, for example, how are the parent companies truly injured if, as assumed by the Court of Appeals, they can conduct "precisely the same foreign commerce" through either American subsidiaries or independent contractors? They are entirely free to select the alternative which, in their view, will have the most favorable tax consequences. Under the reasoning of the Court of Appeals, however, parent companies are injured by having to select between alternatives when they would *prefer* to do business in the form which is the least favorable taxwise. In other words, carried to its logical extreme, the Court of Appeals' decision would permit a foreign company to attack any state tax that negatively impacts on its own preferences.

**3. The purported injury to the parent companies is neither "direct" nor "independent" of their status as corporate stockholders**

Prudential considerations in general and the shareholder standing rule in particular ordinarily prohibit a party from litigating the legal rights of another. See, e.g., *Allen v. Wright*, 468 U.S. 737, 751 (1984). The legal right at issue in the present matter is the right of the corporate taxpayers to have their tax liability determined in a lawful manner—i.e., in a manner which does not violate the Foreign Commerce Clause. Whether the constitutional issue is litigated in suits for refund brought by the corporate taxpayers in the state courts, or whether their foreign parents are permitted to litigate the issue in federal court, the issue remains the same: Do the taxes assessed against the corporate taxpayers interfere with Congress' power to regulate foreign commerce? Thus, the standing question essentially is whether the parent companies may challenge the constitutionality of tax assessments issued against taxpayer-subsidiaries which are perfectly capable of pursuing the same constitutional claims.

The Court of Appeals has concluded that the foreign parents are injured in such a way as to have standing to litigate their subsidiaries' tax liability. As discussed above, the perceived injury to the parents is tenuous at best. In addition, however, the Court of Appeals has failed to offer any reasoned explanation for

treating the perceived injury to the parent companies as either a "direct" injury or as an injury "independent" of their stockholder status.

If the tax liability of a corporate taxpayer is determined in a manner which violates the Foreign Commerce Clause, it seems self-evident that the party *directly* injured by such a tax determination is the corporate taxpayer against which the unlawful taxes are assessed. Conversely, any injuries to a parent-stockholder in such an instance are necessarily *indirect* since they result from the allegedly unlawful taxes assessed against the corporate taxpayer. The Court of Appeals has not explained its logic for concluding otherwise.

The Court does offer some explanation for treating the perceived injury as one not affecting the foreign companies only in their capacity as stockholders, but its explanation is hardly satisfactory. The Court says that the foreign parents not only own the subsidiaries; they own them "as instrumentalities of the foreign commerce of their parents." App., at A15. But why is this a fact of magical proportions? Every wholly-owned subsidiary can be viewed as an instrumentality by which the parent conducts one type of commerce or another—intrastate, interstate or foreign. The fact that a foreign company utilizes an American subsidiary as an instrumentality of foreign commerce should not, therefore, be considered as creating some sort of special relationship between the two for standing purposes.

The decision of the Court of Appeals to the contrary raises, of course, still other questions. How far does its reasoning go? Is federal standing to litigate state tax matters to be accorded only to foreign companies which own American subsidiaries? If so, what is the justification for the different treatment of domestic companies which utilize various subsidiaries as "instrumentalities" of interstate commerce? If federal standing is not to be so limited, will the federal courts be deluged with suits filed by domestic companies which are dissatisfied with the state tax treatment of their subsidiaries? Meanwhile, what happens to the spirit, if not the letter, of the Tax Injunction Act?

### C. The Court of Appeals has confused the issue of respondents' standing with one of the constitutional claims they seek to litigate

A principal contention of respondents on the merits of the controversy is that, when applied to domestic corporations with foreign parents, California's unitary method of taxation violates the "one voice" standard set forth in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1978). In particular, they have pointed to foreign objections to this method of taxation and to the possibility of foreign retaliation. The Court of Appeals has confused these constitutional claims with the essential question of standing: whether the parent-stockholders, or the corporate taxpayers, are the proper parties to litigate the constitutional claims.

The Court of Appeals states, for example, that "To the extent that California's franchise tax burdens foreign companies' decisions to conduct business through subsidiaries operating in California, it threatens to offend this country's trading partners. . . ." App., at A16. It also states that "It is important that these injuries [to Alcan and Imperial] . . . have fueled a simmering trade controversy which has raised concerns about foreign retaliation and the country's ability to speak with one voice on matters of foreign commerce. . . ." *Id.*, at A17. And at footnote 10 of its opinion, the Court reasons that the unitary method "implicates . . . concerns about foreign retaliation" because it "has the potential to shift a higher proportion of the corporate tax burden onto companies that are affiliated with foreign operations."<sup>10</sup> It continues:

<sup>10</sup> This potential also exists, of course, in the case of a multinational enterprise headed by a domestic company. It is also unclear what the Court of Appeals means by its statement that, "The potential for the unitary tax to penalize foreign ownership of American assets distinguishes the unitary tax from environmental or safety regulations that might cause comparable increases in the cost of doing business in California, but would presumably affect foreign and domestically owned operations fairly equally." App., at A15. California's tax treatment of foreign and domestically owned operations is the same. Furthermore, assuming *arguendo* that a foreign company could reduce the cost of doing business in California by choosing to operate solely through independent contractors, thus eliminating the use of foreign factors in

"Evaluation of the constitutional significance of this threat in the particular circumstances presented by California's unitary tax must await the district court's assessment of the merits of this appeal. *We decide only that the potential for constitutionally significant offense is sufficient to create standing.*" (Emphasis added.)

The Court of Appeals has held, in short, that since there may be some merit to the Foreign Commerce Clause claims made by Alcan and Imperial, they have the standing to litigate those claims. This strange twist in standing doctrine puts the cart before the horse. As this Court has repeatedly observed, "standing in no way depends on the merits of the plaintiff's contention that particular conduct is illegal. . . ." *Warth v. Seldin*, 422 U.S. 490, 500 (1975); see also *Flast v. Cohen*, 392 U.S. 83, 99 (1968); *Simon v. Eastern Ky. Welfare Rights Organization*, 426 U.S. 26, 37-38 (1976); *Valley Forge College v. Americans United*, 454 U.S. 464, 476 (1982).

### III

#### THE COURT OF APPEALS' DECISION INVITES WHOLE-SALE AVOIDANCE OF THE TAX INJUNCTION ACT AND ITS UNDERLYING PRINCIPLE OF COMITY

The historic rule that the federal courts will not interfere with the fiscal operations of the states is codified in 28 U.S.C. § 1341 (the Tax Injunction Act). Section 1341 provides:

"The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."

It is well established that 28 U.S.C. § 1341 is an explicit Congressional limitation on the jurisdiction of the federal courts

California's tax computations, exactly the same choice (or in the Court's analysis, exactly the same burden) would be available to domestic parents engaged in foreign commerce by means of a worldwide unitary business.

in the area of state taxation. As this Court stated in *Rosewell v. LaSalle National Bank*, 450 U.S. 503, 522 (1981):

"The statute 'has its roots in equity practice, in principles of federalism, and in recognition of the imperative need of a State to administer its own fiscal operations.' *Tully v. Griffin, Inc.*, 429 U.S. (68), at 73. This last consideration was the principal motivating force behind the Act; this legislation was first and foremost a vehicle to limit drastically federal district court jurisdiction to interfere with so important a local concern as the collection of taxes."

Thus, the Act generally prohibits federal courts from granting injunctive relief in cases involving state tax administration; such relief is permitted only in exceptional circumstances where the state court remedy is not "plain, speedy and efficient." *Id.*, at 512. The same rule is applied to requests for declaratory relief. *California v. Grace Brethren Church*, 457 U.S. 393, 408 (1982).

The Court of Appeals in the present matter concluded that the Tax Injunction Act is inapplicable to the actions brought by Alcan and Imperial because "the Act has not been construed so broadly as to bar a nontaxpayer . . . who lacks a remedy in state court from bringing suit in federal court on the ground that an affiliated taxpayer possesses adequate state court remedies." App., at A18. It also concluded that Alcan and Imperial, "which have no standing in state court, cannot be barred from federal court on the strength of the principles of comity and federalism that have sometimes justified abstention from disputes about state taxes pending before state tribunals." App., at A20.

It is true, as the Court of Appeals has observed (App., at A18), that a tax assessment cannot be challenged in the California courts by a party who is not the taxpayer.<sup>11</sup> It makes little sense to

<sup>11</sup> This should come as no surprise. However, the Court of Appeals appears to question the fairness of such a rule, suggesting that California could avoid the disruptive effect of "unwanted federal intrusion" in its tax matters by affording a state remedy to the stockholders of a corporate taxpayer. App., at A19-A20. The theoretical justification for providing such a remedy, apart from the coercive effect of "unwanted

conclude, however, that Alcan and Imperial are thus deprived of effective state remedies. The two wholly-owned subsidiaries (which are more than "affiliated" taxpayers) unquestionably have adequate remedies in the state courts. See, e.g., *California v. Grace Brethren Church, supra*, at 415. And Alcan and Imperial, which have absolute control over their subsidiaries, obviously are in a position to ensure that these remedies are pursued with vigor. In other words, as the sole stockholders of their respective subsidiaries, both of the parent companies effectively *have* state remedies to pursue. Neither was required to bring these lawsuits to ensure a full challenge to the California taxing procedures.<sup>12</sup>

Under these circumstances, it seems entirely reasonable to view the actions brought by Alcan and Imperial as falling within the literal wording of the Tax Injunction Act. The Act does not use the term "taxpayer;" it prohibits injunctive and declaratory relief against state tax assessments "where a plain, speedy and efficient remedy may be had in the courts of [the] State." In any event, it is clear that the purposes of the Act are frustrated if it is read as permitting a sole stockholder to challenge a state tax assessment in federal court when the corporate taxpayer directly concerned is barred from doing so. Accordingly, if the literal language of the Act is not sufficient to prohibit the federal relief sought by Alcan and Imperial, their actions should be dismissed on the basis of the principle of comity which underlies the Act. See, e.g., *Fair Assessment in Real Estate v. McNary*, 454 U.S. 100 (1981). The deference heretofore given to the administration of state taxes cannot rest on such a flimsy foundation as to permit federal intrusion in state tax matters simply because a federal action is

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federal intrusion," is unclear. Moreover, the cure suggested by the Court of Appeals would likely be as disruptive as the ailment.

<sup>12</sup> In addition, it is to be observed that the Seventh Circuit has let Alcan and Imperial have their cake and eat it too. While the Court bases its determination of standing on the fact that Alcan and Imperial have total control over the way their unitary businesses will be conducted in California, the Court then fails to acknowledge that this same control gives the foreign parents the ability to direct fully how their taxpayer subsidiaries will pursue their California tax remedies.

brought in the name of a sole stockholder rather than the corporate taxpayer.

### CONCLUSION

Justice Stewart once stated that he could not "imagine a case, at least outside the First Amendment area, where a person whose own [ ] tax liability was not affected could ever have standing to litigate the tax liability of someone else." *Simon v. Eastern Ky. Welfare Rights Org.*, 426 U.S. 26, 46 (1976) (Stewart, J., concurring). This is precisely what Alcan and Imperial are attempting to do in the present matter. They are not the aggrieved taxpayers; rather they are attempting to litigate California's tax treatment of two domestic subsidiaries. The decision of the Court of Appeals reversing the dismissal of their complaints cannot be reconciled with decisions in two other circuits. The decision cannot be reconciled with a reasoned application of the rule prohibiting stockholder suits to redress corporate injuries. And, finally, the decision cannot be reconciled with the proscriptions of the Tax Injunction Act and its underlying principle of comity. It is therefore respectfully submitted that a writ of certiorari should issue.

DATED: February 21, 1989

Respectfully submitted,

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(Appendices follow)

**Appendix A**

In the  
United States Court of Appeals  
For the Seventh Circuit

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No. 87-2239

Alcan Aluminium Limited,  
Plaintiff-Appellant,

v.

Franchise Tax Board of the State of California, et al.,  
Defendants-Appellees.

No. 87-2295

Imperial Chemical Industries PLC,  
Plaintiff-Appellant,

v.

Franchise Tax Board of the State of California, et al.;  
Defendants-Appellees.

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Appeals from the United States District Court for the  
Northern District of Illinois, Eastern Division.  
Nos. 84 C 6932 & 84 C 8902—Ann C. Williams, Judge.

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Argued January 20, 1988—Decided October 19, 1988\*

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\* This opinion has been circulated among all judges of this court in regular active service. No judge favored a rehearing in banc because of the arguable conflict with the decisions of the Ninth Circuit in *EMI Ltd. v. Bennett*, 783 F.2d 994 (9th Cir. 1984) and *Shell Petroleum, N.V. v. Graves*, 709 F.2d 593 (9th Cir. 1983).

Before CUDAHY, FLAUM and RIPPLE, *Circuit Judges*.

CUDAHY, *Circuit Judge*. Alcan Aluminium Limited ("Alcan") and Imperial Chemical Industries PLC ("Imperial"), two foreign corporations with American subsidiaries that do business in California, appeal from the district court's dismissal of their constitutional challenge to California's franchise tax. The district court found that the parent companies were injured only in their capacity as shareholders and therefore lacked standing under the well established rule that shareholders must ordinarily demonstrate a direct and independent injury to bring suit. *Alcan Aluminium Ltd. v. Franchise Tax Bd.*, Nos. 84 C 6932, 84 C 8902, mem. op. at 8-10 (N.D. Ill. July 29, 1987). We find that Alcan and Imperial have incurred injuries that are sufficiently direct and independent of the injuries incurred by their subsidiaries to confer standing. We therefore reverse and remand.

# I.

Appellants are foreign corporations with majority interests in domestic companies that conduct business in California. Alcan, a Canadian company, is the sole stockholder of Alcan Aluminum Corporation ("Alcancorp"), an Ohio corporation with operations in California.<sup>1</sup> Imperial, an English holding company, owns over fifty percent of ICI Americas, Inc. ("Americas"), a Delaware corporation that also conducts business in California. California's Franchise Tax Board ("FTB") has assessed, or is in the process of assessing, taxes against both Alcancorp and Americas under California's franchise tax law. See Cal. Gov't Code §§ 15700-

<sup>1</sup> When Alcan initiated this action for declaratory judgment in August 1984, Alcancorp was directly owned by Alcan Aluminium of Canada, Ltd., which was in turn owned by Alcan Aluminium Limited. A subsequent corporate reorganization renamed Alcan Aluminium of Canada, Limited; it is now called Alcan Aluminium Limited. The entity that was called Alcan Aluminium Limited is now Alcan Aluminium Holdings Limited. This change has no bearing on the issues and we follow the parties' sensible convention of using the original name (shortened to "Alcan") for the foreign parent.

15703 (West 1980 & Supp. 1988); Cal. Rev. & Tax Code § 26422 (West 1979).<sup>2</sup>

California does not employ conventional geographic or transactional accounting techniques to determine the locally taxable income of California businesses that transact business with affiliated companies outside the state. Instead, California, like a number of other states, employs a unitary tax approach—known in the California Code as the "unitary business/formula apportionment method." FTB first determines the scope of the "unitary business" in which a California corporation participates with affiliated companies and calculates the total earnings of this unitary enterprise. It then computes an allocation fraction for each affected taxpayer. This fraction is an unweighted average of three ratios, the ratios of California payroll to total payroll, California property value to total property value and California sales to total sales. Multiplying a corporation's allocation fraction by the total income of the unitary business in which it participates yields that corporation's taxable income for purposes of the franchise tax. Cal. Rev. & Tax Code §§ 25128-25137 (West 1979). The Supreme Court has repeatedly rejected claims, in cases involving domestic parent companies, that this three-factor method violates the commerce clause or foreign commerce clause by unfairly overstating the income attributable to operations in the taxing state. See *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 180-84 (1983); *Mobil Oil Co. v. Commissioner of Taxes*, 445 U.S. 425, 438-39 (1980); see also *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 271-75 (1978). However, the Court has expressly left open the issue that appellants now seek standing to raise: whether application of the unitary tax to domestic subsidiaries of foreign corporations violates foreign commerce clause prohibitions on multiple taxation and the impairment of federal uniformity. See *Container Corp.*, 463 U.S. at 189 n.26 & 195 n.32;

<sup>2</sup> The stipulated facts reveal that by the end of 1985, the FTB had computed Americas' taxes under the unitary apportionment method for the years 1972 through 1981, and was completing its audits of Alcancorp's California returns for the years 1965 through 1981. The record does not reveal the current status of Alcancorp's and Americas' state-level challenges.

see also *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 446-51 (1979) (discussing concerns about multiple taxation and the national uniformity that are peculiar to foreign commerce context). These questions have prompted heated diplomatic protest and threats of retaliation by the domiciliary countries of affected foreign corporations.

Alcancorp and Americas, appellants' subsidiaries, are in the midst of contesting the FTB's assessments before California administrative officials and courts. The Tax Injunction Act, 28 U.S.C. § 1341 (1982), prohibits the subsidiaries from obtaining review of the constitutionality of the tax by a federal court until they have exhausted their California appeals.<sup>3</sup> The FTB maintains that the subsidiaries have standing to challenge the franchise tax under the foreign commerce clause in California court and, ultimately, in the United States Supreme Court. Appellants seem to assert, though their position on this point is confused and perhaps inconsistent, that their domestic subsidiaries have no standing to challenge the constitutionality of the franchise tax.<sup>4</sup> In

<sup>3</sup> The Act states that "[t]he district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State." 28 U.S.C. § 1341 (1982).

<sup>4</sup> In its opening brief, Imperial stated that Americas "is not engaged in foreign commerce and cannot raise a claim under the Commerce Clause . . . because it has suffered no injury to its foreign commerce." Brief of Plaintiff-Appellant Imperial Chemical Indus. PLC at 14. The FTB's response contested Imperial's idiosyncratic view that Americas could be uninvolved in foreign commerce while Imperial was engaged in foreign commerce by virtue of transactions with Americas. Brief of Appellees, at 23. Imperial's response, that "Americas' foreign commerce is minimal," that the tax "does not directly affect Americas' foreign trade" and that Imperial suffers "the greater loss" from any diminution in trade caused by the tax, do not salvage its position. Reply Brief of Plaintiff-Appellant Imperial Chemical Indus. PLC at 13-14. Nor does the non sequitur that Alcan threw into the breach: "[any] burdens on foreign commerce, . . . must of necessity be burdens exclusively on Appellant, not its U.S. subsidiary, since those burdens relate exclusively to the inclusion of Appellant and its non-U.S. subsidiary's foreign activities

any event, appellants have not given us any convincing reason to doubt that the California courts will entertain Alcancorp's and Americas' foreign commerce clause arguments; so we must proceed on the (perhaps not wholly clear) assumption that the subsidiaries can press these constitutional claims in state court.

This case requires us to revisit an issue identified but left unresolved in *Alcan Aluminium Ltd. v. Department of Revenue*, 724 F.2d 1294 (7th Cir. 1984) ("*Alcan II*"). *Alcan II* dismissed Alcan's challenge to Oregon's unitary tax as unripe for adjudication until such time as Oregon actually determined that Alcancorp owed franchise taxes. Although we stressed that the dismissal on ripeness grounds implied no position "as to whether appellant will have standing to challenge appellees' actions if appellees do assess Alcancorp as part of a unitary business including appellant," we stated in dictum that if Alcan's factual allegations were taken as true neither Alcan's shareholder status nor the Tax Injunction Act's bar on federal district court suits for declaratory or injunctive relief against state taxes would prevent Alcan from obtaining standing once the dispute became ripe. *Id.* at 1299. The case before us places the standing issue, an issue which may have important implications for the growing conflict between the United States and nations where parent corporations affected by unitary taxes are domiciled, squarely before this court.

## II.

Standing doctrine imposes two types of restrictions on litigants seeking access to federal courts: "constitutional limitations on federal court jurisdiction and prudential limitations on its exercise." *Warth v. Seldin*, 422 U.S. 490, 498 (1975); see *Gladstone, Realtors v. Village of Bellwood*, 441 U.S. 91, 99-100 (1979). The FTB does not seriously contest plaintiffs' claims that their interest in challenging the California franchise tax satisfies the case or controversy requirement of article III, section 2. The plaintiffs'

into the California tax base." Reply Brief of Appellant Alcan Aluminium Limited at 7. Appellants were no more successful in their attempts to illuminate their one-way theory of foreign commerce at oral argument.

ownership interests in their domestic subsidiaries alone, considered apart from the direct harms they incur as participants in foreign commerce (discussed below), clearly give them "such a personal stake in the outcome of the controversy as to assure that concrete adverseness which sharpens the presentation of issues upon which the Court so largely depends for illumination of difficult constitutional questions." *Baker v. Carr*, 369 U.S. 186, 204 (1962).

The dispute here centers on the more elusive, prudential guidelines that the "Court [has] developed, for its own governance in the cases confessedly within its jurisdiction." *Ashwander v. Tennessee Valley Auth.*, 297 U.S. 288, 346 (1936) (Brandeis, J., concurring). The prudential aspect of the standing inquiry, like the constitutional aspect, derives fundamentally from "concern about the proper—and properly limited—role of the courts in a democratic society." *Warth*, 422 U.S. at 498; see also *Duke Power Co. v. Carolina Envtl. Study Group, Inc.*, 438 U.S. 59, 80 (1978); *Peoples Gas, Light & Coke Co. v. United States Postal Serv.*, 658 F.2d 1182, 1195 (7th Cir. 1981). No single formula has been devised for resolving all standing issues in the manifold contexts in which they arise; nothing in the Supreme Court's recent standing decisions belies the observation, now nearly two decades old, that "[g]eneralizations about standing to sue are largely worthless as such." *Association of Data Processing Serv. Orgs., Inc. v. Camp*, 397 U.S. 150, 151 (1970).

Two large and familiar features of the jumbled standing landscape stand out as useful guideposts for our inquiry in this case. First, it is clear that a plaintiff may only bring suit to vindicate a particularized, personal interest. Generalized grievances do not confer standing, nor do claims to relief resting on "the legal rights or interests of third parties." *Warth*, 422 U.S. at 499; see *Tileston v. Ullman*, 318 U.S. 44 (1943). This principle of judicial self-restraint prevents courts from interfering unnecessarily in "abstract questions of wide public significance" that "other governmental institutions may be more competent to address." *Warth*, 422 U.S. at 500.

Second, it is clear that the courts must look to congressional intent when they seek to place appropriate limits on federal

judicial power. In the context of administrative action challenged as violative of the governing statutory standard, the Supreme Court has held that "at bottom the reviewability question turns on congressional intent, and all indicators helpful in discerning that intent must be weighed." *Clarke v. Securities Indus. Ass'n*, 107 S. Ct. 750, 758 (1987); see *Block v. Community Nutrition Inst.*, 467 U.S. 340, 351 (1984). A corollary, more pertinent here, holds that standing to bring constitutional challenges to state actions may be precluded by an express or implied congressional prohibition. In *California v. Grace Brethren Church*, 457 U.S. 393 (1982), for example, the Supreme Court held the Tax Injunction Act, which expressly prohibits taxpayer suits for injunctive relief in order to prevent federal courts from interfering with the assessment of state taxes, impliedly prohibits suits for declaratory relief as well. *Id.* at 407-11.

This case, as we shall see, also implicates judge-made equitable principles under which federal courts have found disputes over state taxes to be nonjusticiable (though typically under the rubric of abstention rather than lack of standing). These principles are distinct from, though consistent with, the comity concerns that Congress sought to protect through the Tax Injunction Act. See *Fair Assessment in Real Estate Ass'n, Inc. v. McNary*, 454 U.S. 100 (1981). The issue is whether, in the circumstances of this case, the equitable principles that favor deference to states on revenue questions outweigh the countervailing obligation of the federal courts to provide a forum for a litigant with no effective state remedy.

### III.

#### A.

The FTB's arguments against standing purport to rely on these prudential standing principles. First, the FTB argues that the injuries of which Alcan and Imperial complain are indirect injuries incurred by the appellants in their capacity as shareholders of AlcanCorp and Americas. The FTB contends that the prudential bar on standing to enforce third parties' rights encompasses a well established prohibition on shareholder suits to

redress injuries to their corporations. Longstanding equitable restrictions on shareholder suits, the FTB points out, generally prohibit shareholders from initiating actions to enforce the rights of the corporation unless they can demonstrate that they have taken appropriate steps to persuade the corporate managers to pursue the same action and that the managers refused for reasons other than good faith business judgment. *See Twohy v. First Nat'l Bank*, 758 F.2d 1185, 1194 (7th Cir. 1985); *Swanson v. Traer*, 249 F.2d 854, 859-61 (7th Cir. 1957); *see also* Fed. R. Civ. P. 23.1 (requirements for bringing shareholder derivative action in federal court). An exception to this rule exists, however. Shareholders with direct, personal interests in a cause of action can bring suit even if the corporation's legal rights and obligations are also implicated. *Simcox v. San Juan Shipyard, Inc.*, 754 F.2d 430, 438 (1st Cir. 1985); *Buschmann v. Professional Men's Ass'n*, 405 F.2d 659, 661-63 (7th Cir. 1969); *Schaffer v. Universal Rundle Corp.*, 397 F.2d 893, 896 (5th Cir. 1968) (stockholder may bring an individual action "where the wrong itself amounts to a breach of duty owed to the stockholder personally").

This case requires us to determine whether Alcan's and Imperial's particular injuries are sufficiently direct and personal to confer standing. The parent companies contend that they are directly injured because they incur significant accounting costs as a result of California's reliance on a unitary tax base, because California effectively taxes the income of overseas affiliates that is already subject to taxes in other jurisdictions and because the tax impairs their subsidiaries' value as instrumentalities of foreign commerce. The FTB counters that each of the harms described by the appellants was incurred indirectly, through the parent corporations' status as shareholders in AlcanCorp and Americas.

To determine the scope of the exception, we must consider the nature and purposes of the shareholder standing rule. Limitations on shareholder derivative suits in federal courts were originally imposed to curb the use of shareholder suits as a means of invoking diversity jurisdiction when the corporation itself could not. *See Hawes v. City of Oakland*, 104 U.S. 450, 459-60 (1881); *see generally* 7C C. Wright, A. Miller & M. Kane, *Federal Practice and Procedure* § 1821 at 10-13 (1986) (describing con-

text of the *Hawes* holding and its subsequent codification in federal rules). Later, the Supreme Court indicated that the bar on shareholder standing also protects the rights of shareholders who control a majority of voting shares to make binding decisions about the enforcement of corporate rights. *See, e.g., Corbus v. Alaska Treadwell Gold Mining Co.*, 187 U.S. 455, 463 (1903) ("It is not a trifling thing for a stockholder to attempt to coerce the directors of a corporation to an act which their judgment does not approve, or to substitute his judgment for theirs."); *see also Swanson*, 249 F.2d at 859-60.<sup>5</sup> Courts and commentators have since recognized that the deterrence of "strike suits," shareholder derivative actions brought for the purpose of eliciting lucrative settlements from management rather than to force the corporation to pursue some viable cause of action, is an important objective underlying the shareholder standing requirements. *See, e.g., Lewis v. Curtis*, 671 F.2d 779, 788 (3d Cir.), *cert. denied*, 459 U.S. 880 (1982); *Brink v. Dalesio*, 667 F.2d 420, 428 (4th Cir. 1981); Note, *Trust Beneficiary Standing in Shareholder Derivative Actions*, 39 Stan. L. Rev. 267, 273-74 (1986).

In a number of more recent cases, federal courts have denied individual standing to shareholders notwithstanding that these shareholders controlled a majority of voting shares and that subject matter jurisdiction did not depend on the individual plaintiff's residence. In *Gregory v. Mitchell*, 634 F.2d 199 (5th Cir. 1981), for example, controlling shareholders in a bank were prevented from suing as individuals under 42 U.S.C. section 1983 for alleged discriminatory treatment by state regulators. *Accord Jones v. Niagara Frontier Trans. Auth.*, 836 F.2d 731, 736 (2d

<sup>5</sup> Justice Brandeis' concurrence in *Ashwander v. Tennessee Valley Authority*, 297 U.S. 288, 342-44 (1936), relied in part on the rights of shareholder majorities to support his contention that the shareholder plaintiffs lacked standing. Chief Justice Hughes' lead opinion (which, like Justice Brandeis' concurrence, garnered four votes) found standing based on stockholders' allegations that corporate directors' breached a duty to stockholders by failing to oppose illegal government action. *Id.* at 318-23. Both opinions looked to the purposes for limiting shareholder standing and the particular facts of the case at hand to assess the status of the plaintiffs in that case.

Cir. 1987); *Erlich v. Glasner*, 418 F.2d 226 (9th Cir. 1969); see also, e.g., *Sherman v. British Leyland Motors, Ltd.*, 601 F.2d 429, 439-40 (9th Cir. 1979) (sole shareholder in automobile dealership cannot sue in individual capacity in claims arising under Automobile Franchise Act, antitrust laws or in pendent state claims); *Von Brimer v. Whirlpool Corp.*, 536 F.2d 838, 846 (9th Cir. 1976) (majority shareholder barred from suing for interference with corporation's contractual relations; following rule "avoids multitudinous litigation and recognizes the corporate entity"); *Smith v. Martin*, 542 F.2d 688, 690 (6th Cir. 1976), cert. denied, 431 U.S. 907 (1977). But see *Leverett v. City of Pinellas Park*, 775 F.2d 1536, 1538-39 (11th Cir. 1985) (liberal approach to standing in first amendment area makes shareholder standing bar inapplicable where individuals seek to raise corporation's first amendment claims). None of these decisions provides a detailed justification for applying the rule against shareholder standing to situations where shareholder suits do not threaten to circumvent the limits on diversity jurisdiction or to undermine managerial decisionmaking. *Von Brimer* and *Erlich*, however, suggest that in this context, the prohibition on shareholder actions rests primarily on considerations of judicial economy and the importance of avoiding a multiplicity of suits. See *Von Brimer*, 536 F.2d at 846; *Erlich*, 418 F.2d at 228. See generally 12B W. Fletcher, *Cyclopedia of the Law of Private Corporations* §§ 5909-5911 (rev. perm. ed. 1984).

This brief overview points up an important difference between limitations on shareholder standing and the general prudential requirements. Though prudential in the sense that they are judge-made restrictions on the availability of the federal courts, traditional limitations on shareholder standing derive from broader origins than do the general prudential restrictions. When courts bar shareholders from bringing suit in order to prevent corporations from circumventing statutory limits on diversity jurisdiction or to prevent minority shareholders from interfering with the operation of the corporation, they are animated by concerns about the limits on judicial power and the appropriateness of a particular plaintiff bringing a particular action—issues at the core of what we have been calling the prudential aspect of the standing question. But when courts bar shareholder suits solely to avoid a

multiplicity of suits and to conserve judicial resources, in situations where neither the manipulation of diversity jurisdiction nor the maintenance of majority control is at issue, they are animated by qualitatively different concerns. The focus in this latter class of cases is on "[w]ise judicial administration, giving regard to conservation of judicial resources and comprehensive disposition of litigation," *Colorado River Water Conservation Dist. v. United States*, 424 U.S. 800, 817 (1976) (quoting *Kerotest Mfg. Co. v. C-O-Two Fire Equip. Co.*, 342 U.S. 180, 183 (1952)). In deciding whether to abstain from a controversy in deference to a parallel state court proceeding—a decision resembling the prudential aspect of a standing determination both in its effect and in its attention to prudential considerations—the Supreme Court has held that the conservation of judicial resources can only in "exceptional circumstances" justify the withholding of federal jurisdiction in spite of "the virtually unflagging obligation of the federal courts to exercise the jurisdiction given them." *Id.*; see *Moses H. Cone Memorial Hosp. v. Mercury Constr. Co.*, 460 U.S. 1, 13-19 (1983).<sup>6</sup> While the courts' housekeeping concerns certainly warrant consideration, we believe that *Colorado River* and *Moses H. Cone* place them on a lower footing than concerns about preventing the courts from trenching on the prerogatives of elected officials. Thus, in addressing whether injuries to foreign parents are sufficiently direct to confer standing, we attend to which of the several aims of the shareholder standing "rule" would be served by its invocation.<sup>7</sup>

<sup>6</sup> *Colorado River* does list federal court actions to restrain the collection of state taxes as one of the few categories of cases in which abstention may be appropriate. 424 U.S. at 816. We discuss the comity and federalism argument for denying standing in Part II. B. below.

<sup>7</sup> Our research has revealed only two cryptic references to the relationship between shareholder standing rules and the general prudential limits on standing. See *Shell Petroleum, N.V. v. Graves*, 570 F. Supp. 58, 63 n.6 (N.D. Cal.) ("The requirement that a shareholder establish injury to rights specifically vested in it individually, distinct from those of the corporation . . . might or might not be a particular instance of the more general prudential standing principles quoted above. But in any event, the requirement must be satisfied."), *aff'd*, 709 F.2d 593 (9th

Only a handful of decisions have considered whether foreign parents have standing to contest the constitutionality of unitary taxes assessed on their domestic subsidiaries. In general, they have denied standing; and they have all relied upon a broad formulation of the rule limiting shareholder standing. In *Shell Petroleum, N.V. v. Graves*, 709 F.2d 593, 595-56 (9th Cir.), cert. denied, 464 U.S. 1012 (1983), the Ninth Circuit found that the injury suffered by a parent corporation due to the multiple taxation of foreign income was indirect, entirely derivative of injuries to its California subsidiary.<sup>8</sup> *Accord EMI Ltd. v. Bennett*, 738 F.2d 994, 996-99 (9th Cir.), cert. denied, 469 U.S. 1073 (1984). Similarly, a New York district court has held, and the Second Circuit has affirmed, that Alcan lacked standing to sue the FTB because Alcan had not demonstrated that it incurred a direct injury or that the FTB owed Alcan some independent duty. *Alcan Aluminium Ltd. v. Franchise Tax Bd.*, 558 F. Supp. 624, 628-29 (S.D.N.Y.), aff'd mem., 742 F.2d 1430 (2d Cir. 1983), cert. denied, 464 U.S. 1041 (1984) (hereinafter "*Alcan I*").<sup>9</sup> The district court rejected Alcan's claim that the unconstitutional

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Cir.), cert. denied, 464 U.S. 1012 (1983); Note, *The Demand and Standing Requirements in Stockholder Derivative Actions*, 44 U. Chi. L. Rev. 168, 168 n.5 (1976) ("Standing' in the context of derivative actions is not to be confused with its more traditional meaning as defining when an individual can challenge governmental action.").

<sup>8</sup> *Shell* also affirmed the district court's alternative holding that *Shell*'s claim would not be ripe until its American subsidiaries had exhausted their remedies before California administrative bodies. 709 F.2d at 596-97. The district court held that even if *Shell* had not run afoul of the prohibition on shareholder standing, its injury would not be sufficiently certain and immediate to be deemed ripe until its subsidiaries had exhausted their state-level challenges. *Shell Petroleum, N.V.*, 570 F. Supp. at 65-66. The district court predicated this strict ripeness requirement on the comity and federalism concerns that gave rise to the Tax Injunction Act and the Supreme Court's continuing recognition of limits on its equity powers even where the Act is inapplicable. *Id.* at 66. We discuss these matters further below.

<sup>9</sup> An earlier district court decision in *Alcan I* stayed federal court proceedings, including resolution of the standing issue, pending resolution of Alcan's challenges before state administrative bodies and courts.

taxation of an "instrumentality of foreign commerce" in its control constituted a direct injury sufficient to confer standing. *Alcan I*, 558 F. Supp. at 629.

There may well be some merit to the discussions of compliance costs and the double taxation of income in these decisions insofar as these factors, *in themselves*, were deemed insufficient to constitute direct injuries to the parent companies. The information demands of which Alcan and Imperial complain were presented, as the district court pointed out, to AlcanCorp and Americas, not to their foreign parents. Mem. op. at 10. Alcan and Imperial may find it in their interest to expend the considerable sums that they say will be required to produce the worldwide figures for the unitary enterprises that California has requested from their subsidiaries. Or they may find it more advantageous to accept the penalties that California will impose on its subsidiaries for failing to produce the figures. In either event, one could view the information demands as affecting Alcan and Imperial by reducing the profitability of their California operations, net of the administrative costs that these operations impose on the world-

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*Alcan Aluminium Ltd. v. Franchise Tax Bd.*, 539 F. Supp. 512, 516 (S.D.N.Y. 1982).

Because Alcan lost on standing grounds in *Alcan I*, one might have expected the FTB to pursue a collateral estoppel defense in this action. See *Planned Parenthood Ass'n v. Kempiners*, 700 F.2d 1115, 1138 (7th Cir. 1983). Indeed, the FTB did move to dismiss Alcan's complaint on collateral estoppel grounds in the district court, but its motion was denied. The FTB's cross-motion for summary judgment requested reconsideration of collateral estoppel as an alternative basis for dismissing Alcan's suit, but the district court did not discuss this argument.

On appeal, the FTB virtually ignores this issue. It characterizes *Alcan I* first as "[a]n action similar to the present one," Brief of Appellees at 11 n.5, and later as a case that "alleged grounds for relief . . . substantially identical to those asserted here," *id.* at 29. Appellees' only reference to collateral estoppel appears in a footnote discussing the fate of the collateral estoppel claim in the district court. This is notably less than the presentation of legal authority and facts about the two cases that would be required for us to address the collateral estoppel argument on appeal. See *Bonds v. Coca-Cola Co.*, 806 F.2d 1324 (7th Cir. 1986); *Manbourne Inc. v. Conrad*, 796 F.2d 884, 888, 890 n.6 (7th Cir. 1986).

wide enterprises. By possible analogy if California enacted environmental or worker safety regulations requiring corporate taxpayers to produce costly information obtainable only through their foreign parents, it would be questionable whether foreign parents would have independent standing to challenge those regulations (at least so long as there was no indication that the regulations were not a mere pretext for raising costs of foreign-owned enterprises). Of course, it is entirely possible, though Alcan and Imperial have made no such claim here, that some parent companies' accounting systems attribute some of the costs of complying with unitary tax systems (or with environmental regulations) to foreign affiliates. But the nominal incidence of compliance costs under a company's own accounting system would not, in itself, normally be determinative of "direct" injury. The compliance costs can be viewed, in principle, as an increase in the overhead of the California operations; under that view, the foreign parents incur harm as shareholders in an enterprise faced with increased costs. See *EMI Ltd.*, 738 F.2d at 997; *Shell Petroleum, N.V.*, 709 F.2d at 595-96; see also *Alcan I*, 558 F. Supp. at 628-29 & n.9.

Somewhat similar considerations may apply to the double taxation claim, although only as that claim is narrowly construed. Alcan and Imperial point out that California's unitary tax scheme is inconsistent with the transactional approach employed by most if not all foreign nations (as well as the United States government), which allocates profits among affiliated operations by estimating the distribution of profits that would result from arm's length transactions. Alcan and Imperial contend that California's taxation of corporate income, on which foreign affiliates must pay taxes to their host governments under a transactional tax system, directly injures the foreign parents. But it is possible to view these taxes, like compliance costs, simply as added costs for the domestic subsidiary, experienced by the foreign parent as a decline in the after-tax profits of its California operations. See *EMI Ltd.*, 738 F.2d at 996 (parent's "only real connection to the live controversy is in its status as majority shareholder"); *Shell Petroleum, N.V.*, 709 F.2d at 595 ("[unitary] method of taxation . . . does not injure [parent] directly or independently of the corporation").

However, the arguments that Alcan and Imperial incur no direct and independent injury from costs plausibly viewed as burdens on their subsidiaries remains persuasive only so long as the relationship between parents and subsidiaries is viewed narrowly, focusing exclusively on the parents' status as shareholders. It is indisputable that, but for their ownership of stock in corporations that operate in California, Alcan and Imperial would have no complaint about either compliance costs or double taxation. This line of argument, however, ignores a second important feature of the relationship between the foreign parents and their domestic subsidiaries: the subsidiaries are owned as instrumentalities of the foreign commerce of their parents. Foreign companies seeking to sell or purchase products or services in California choose between conducting business through dealings with American subsidiaries or through contracts with unrelated companies. Plaintiffs allege that for many enterprises subject to the unitary tax, the earnings of operations in California, computed under the arm's length transaction approach, are lower in relation to labor costs, capital assets and sales than are the similarly computed earnings of related operations in countries other than the United States. These companies will show a higher taxable income in California under the unitary tax scheme than they would if they engaged in precisely the same foreign commerce through arm's length contracts with unaffiliated companies. From the perspective of the foreign parent, therefore, the unitary tax diminishes the attractiveness of owning American subsidiaries in comparison with entering into contracts with independent companies as a means of engaging in foreign commerce. The potential for the unitary tax to penalize foreign ownership of American assets distinguishes the unitary tax from environmental or safety regulation that might cause comparable increases in the cost of doing business in California, but would presumably affect foreign and domestically owned operations fairly equally. It is the incidence of the unitary tax, its potential to disfavor a particular mode of foreign participation in the American economy, rather than the

magnitude of the costs it imposes that provides the strongest argument for standing.<sup>10</sup>

Viewed in these terms, Alcan's and Imperial's injuries are direct and independent of the injury to their subsidiaries and standing should follow. To the extent that California's franchise tax burdens foreign companies' decisions to conduct business through subsidiaries operating in California, it threatens to offend this country's trading partners, many of whom must deal with conflicting internal views on the proper role of American investment in their economies, and to elicit retaliatory measures. Concern about precisely this type of foreign response to states' taxation of foreign interests has led the Supreme Court to find stricter limits on state taxes in the foreign commerce clause than in the interstate commerce clause. *Japan Line*, 441 U.S. at 444-45. The record in this case contains numerous indications that foreign governments view California's and other states' sharp departures from the international norm of taxing corporate income based on transactional allocations of income as a source of serious injury to multinationals located within their borders and a

<sup>10</sup> The tax burden on companies subject to California's franchise tax will depend, of course, on the tax rate as well as on the proportion of worldwide earnings attributed to California's operations. A state that applies a high tax rate to earnings computed according to the arm's length transaction method can depress after-tax earnings available to a foreign parent more than a state that applies a lower rate to the unitary revenues. See *Container Corp.*, 463 U.S. at 195. However, a unitary tax system has the potential to shift a higher proportion of the corporate tax burden onto companies that are affiliated with foreign operations. It is this possibility that implicates the concerns about foreign retaliation that have guided the court's interpretation of the foreign commerce clause. See *Japan Line*, 441 U.S. at 456; see also *Container Corp.*, 463 U.S. at 189 n.26, 195 n.32 (noting possibility that application of unitary tax to domestic subsidiaries of foreign companies may offend trading partners); cf. *Asahi Metal Indus. Co. v. Superior Court*, 107 S. Ct. 1027, 1034-35 (1987). Evaluation of the constitutional significance of this threat in the particular circumstances presented by California's unitary tax must await the district court's assessment of the merits of this appeal. We decide only that the potential for constitutionally significant offense is sufficient to create standing.

threat to commercial relations with the United States.<sup>11</sup> To be sure, burdening the use of California subsidiaries as an instrumentality of foreign commerce does not necessarily harm Alcan and Imperial exclusively. AlcanCorp and Americas may incur parallel injuries by virtue of their participation in the same foreign commerce. But the choices about the manner in which international trade is to be conducted are primarily the parents' choices. To dismiss the injury to the foreign parents caused by the distortion of these choices as indirect and derivative is to expand the shareholder standing rule in an area where its underpinnings are weakest. While we might save some federal courts' resources by confining foreign parents to their subsidiaries' remedies in state tribunals, to achieve these marginal savings we would have to overlook the real sense in which California's franchise tax directly and independently injures Alcan and Imperial. It is important that these injuries, which the FTB would have us label indirect under an expansive view of the shareholder standing bar, have fueled a simmering trade controversy which has raised concerns about foreign retaliation and the country's ability to speak with one voice on matters of foreign commerce—concerns that are central to the purposes of the foreign commerce clause.<sup>12</sup>

<sup>11</sup> See, e.g., United Kingdom Finance Act of 1985, New Clause 27 (authorizing Treasury of United Kingdom, subject to parliamentary review, to withdraw United Kingdom tax credit from United States companies with substantial operations in unitary tax states), reprinted in Appendix to the Brief of Plaintiff-Appellant Imperial Chemical Indus. PLC, Item 8; Brief Amicus Curiae Filed on Behalf of the Member States of the European Communities and the Governments of Australia, Japan and Switzerland, No. 87-2295 at 2 (Aug. 27, 1987) ("This case involves issues of vital importance to the fifteen countries and to their future economic and commercial relations with the U.S.").

<sup>12</sup> Insofar as the Ninth Circuit's decisions in *Shell Petroleum, N.V.* and *EMI Ltd.*, may conflict with our holding, we are not persuaded to follow them.

## B.

The FTB also asserts that Alcan and Imperial are barred from federal court by the principles of comity that have traditionally deterred federal courts from interfering with state revenues. These principles were partially codified in the Tax Injunction Act, which prohibits district courts from enjoining, suspending or restraining state taxes "where a plain, speedy and efficient remedy may be had in the courts of such State." 28 U.S.C. § 1341 (1982). But that Act is inapplicable here. The Act has been interpreted broadly, in light of Congress' intent "to prevent federal-court interference with the assessment and collection of state taxes," to bar declaratory as well as injunctive relief for plaintiffs with adequate state remedies. *California v. Grace Brethren Church*, 457 U.S. 393, 411 (1982). The Court has also adopted a lenient construction of the "plain, speedy and efficient" proviso. *Id.* at 412-13; *Rosewell v. LaSalle Nat'l Bank*, 450 U.S. 503, 512-14 (1981). However, the Act has not been construed so broadly as to bar a nontaxpayer (like the parent companies involved here) who lacks a remedy in state court from bringing suit in federal court on the ground that an affiliated taxpayer possesses adequate state court remedies. The FTB concedes that California's administrative and judicial remedies are available only to the taxpaying subsidiaries and not to their parents. Thus, the Tax Injunction Act does not, by its terms, undermine Alcan's and Imperial's entitlement "to a judicial remedy in which they can participate as a party." *Alcan II*, 724 F.2d at 1297 (quoting *Capitol Indus.-EMI, Inc. v. Bennett*, 681 F.2d 1107, 1119 (9th Cir.), cert. denied, 455 U.S. 943 (1982)).

The inapplicability of the Tax Injunction Act, however, does not settle the issue. The Act left intact federal courts' "discretionary power to grant or withhold relief so as to avoid needless obstruction of the domestic policy of the states." *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293, 298 (1943). In some circumstances, this discretion, guided by considerations of comity and federalism, may be exercised to bar suits against state tax assessments to which the Tax Injunction Act is inapplicable. See *Fair Assessment in Real Estate Ass'n Inc. v. McNary*, 454 U.S. 100, 110-13 (1981) (suit for money damages under 42

U.S.C. section 1983); *Great Lakes*, 319 U.S. at 298-99 (suit for declaratory judgment);<sup>13</sup> see also *Colorado River*, 424 U.S. at 816 (aversion to interference with state revenues represents one of few, limited grounds for federal abstention); cf. *Burford v. Sun Oil Co.*, 319 U.S. 315, 332-34 (1943) (abstention from request to enjoin order of regulatory commission where suit "involves basic problems of [state] policy"). In *Alcan II*, we held that "the principle of comity militates in favor of a stringent standard of justiciability in cases that threaten to interfere with state taxes." 724 F.2d at 1298. Justiciability in that case turned on a ripeness question: whether the costs to a foreign parent of producing the information required for a unitary tax audit, before the unitary tax in question had even been held applicable, were "sufficient to overcome the prudential considerations of comity." *Id.* at 1299. While we held that the controversy was not yet ripe, we declined to address whether the same prudential concerns would deprive the parent corporation of standing in the event that the audit produced a determination that the unitary tax applied. *Id.*

We hold that comity and federalism, weighty as these concerns are where federal courts pass on the constitutionality of state tax legislation, cannot justify withholding federal jurisdiction from a party with no cause of action in state court to redress its own direct and independent injury. This is especially true where important, and apparently pressing, considerations of international comity as well as comity within our own federal system are at stake. Neither *Great Lakes* nor *McNary*, in which the Supreme Court invoked equitable abstention to avoid federal court interference with state revenue sources, turned aside parties who could not themselves sue in state court.<sup>14</sup> It is also significant that

<sup>13</sup> *Great Lakes* declined to decide whether the Tax Injunction Act applied to suits for declaratory judgment, reasoning that considerations of comity justified the refusal to hear such a suit even if the statute did not literally apply. Subsequently, *California v. Grace Brethren Church* revisited the issue and expressly held that the Act did not distinguish between suits for declaratory and injunctive relief. 457 U.S. at 408-11.

<sup>14</sup> In *Alcan Aluminium Ltd. v. Franchise Tax Bd.*, 539 F. Supp. 512, 515-16 (S.D.N.Y. 1982), the district court did invoke equitable abstention to stay Alcan's federal suit, despite Alcan's lack of standing in state

California presumably possesses a ready remedy for unwanted federal intrusion. To eliminate federal court jurisdiction over disputes of this nature, the state need only provide foreign parent companies with a "plain, speedy and efficient" remedy of their own in state court. *See Capitol Indust.-EMI*, 681 F.2d at 1119 n.32; *Alcan Aluminium*, 539 F. Supp. at 516 n.9. With such effective means of self-help for the state so near at hand, we cannot conclude that comity requires us to deny plaintiffs the opportunity to appear as named parties to litigate their constitutional claims.

## IV.

We find that Alcan and Imperial, owners of controlling interests in American subsidiaries that function as instrumentalities of their foreign commerce, have alleged injuries resulting from California's franchise tax that are sufficiently direct and independent of the injuries to their subsidiaries to confer standing. We further find that the foreign parent companies, which have no standing in state court, cannot be barred from federal court on the strength of the principles of comity and federalism that have sometimes justified abstention from disputes about state taxes pending before state tribunals. We therefore reverse and remand for further proceedings.

REVERSED AND REMANDED

A true Copy:  
Teste:

*Clerk of the United States Court of  
Appeals for the Seventh Circuit*

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court. The stay remained in force for nine months before it was superseded by an order dismissing the suit on standing grounds. *See Alcan I*, 558 F. Supp. 624.

## Appendix B

In the United States District Court  
for the Northern District of Illinois  
Eastern Division

No. 84 C 6932

Alcan Aluminum Limited,  
Plaintiff,

v.

Franchise Tax Board of the State of California, et al.,  
Defendants.

No. 84 C 8902

Imperial Chemical Industries PLC,  
Plaintiff,

v.

Franchise Tax Board of the State of California, et al.,  
Defendants.

## MEMORANDUM OPINION AND ORDER

In these related cases, the plaintiffs Alcan Aluminum Limited ("Alcan") and Imperial Chemical Industries PLC ("Imperial") are corporations who are based and only do business in countries other than the United States. Alcan and Imperial each wholly own a subsidiary corporation doing business in California. The defendant Franchise Tax Board of the State of California<sup>1</sup> ("Board"), which has the power and duty to administer the California tax laws, has assessed on those subsidiaries an income tax pursuant to California's system of worldwide unitary income taxation. Alcan and Imperial assert that the unitary income tax as applied in this case is an unconstitutional burden on foreign commerce. But because the court finds that neither Alcan nor Imperial have standing to challenge the tax assessments on their

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<sup>1</sup> Alcan and Imperial have also named as defendants a number of officers of this organization.

domestic subsidiaries, the court dismisses both cases without reaching the foreign-commerce claims.

Alcan is a corporation organized and existing under the laws of Canada. Its headquarters and principal place of business are in Montreal, Quebec. Alcan and its various subsidiaries are engaged in all phases of the aluminum business on an international scale. Although Alcan itself does not do business in the United States, it indirectly owns all of the issued stock of Alcan Aluminum Corporation ("Alcancorp"), a corporation organized under the laws of Ohio and with its principal place of business in Cleveland. Alcancorp fabricates and sells various aluminum products in the United States. Alcancorp conducts a portion of its business in California.

Imperial is an English public limited company having its principal offices and place of business in London, England. Imperial has about 400 subsidiaries in which it has more than a fifty-percent ownership interest. Imperial itself does not do business in California or elsewhere in the United States, but Imperial's wholly owned subsidiary, ICI Americas Inc. ("Americas"), does do business in California. Specifically, since 1971 Americas has conducted business in California principally through the operation of a pharmaceutical manufacturing plant in Pasadena as well as other sales and manufacturing activities.

The Board is an official California agency whose responsibilities include administration, collection and enforcement of the state's corporate income and franchise taxes. The "unitary apportionment" formula used by the Board is a method of determining the amount of income of a taxpayer attributable to and taxable by California. Under this method, all business activities that are deemed to function as a "unitary" business are combined. The portion of the combined income attributable to activities in California is determined by a formula that compares the property, payroll and sales of the unitary business in California to the property, payroll and sales of the unitary business everywhere.

For the tax years in question, the Board determined that Alcancorp and Americas were part of a worldwide unitary business that included their foreign parent corporations, Alcan and

Imperial respectively. Based upon this determination, the Board computed the subsidiaries' business income subject to the California tax by applying the aforementioned three-factor apportionment formula. The resulting tax liability for each of the subsidiaries was greater than it otherwise would have been had the Board used the most commonly used international accounting principles.

Subsequently, Alcan and Imperial brought these separate suits in which they allege that the unitary apportionment method of accounting is an unconstitutional burden on the United States' ability to regulate foreign commerce. See U.S. Const. art. I, § 8, cl. 3. Specifically, the foreign parent corporations request that this court enjoin the Board from assessing, levying or collecting any tax from their domestic subsidiaries based upon the unitary apportionment formula because of the risk of double taxation, the cost of compliance incurred by the foreign parents and the objections of and possible retaliation by foreign governments. On January 1, 1985, Judge Marshall made the finding that these cases were related. On June 14, 1985, both cases were reassigned to this court. The parties have filed cross motions for summary judgment and stipulated to the relevant facts. The United States and a number of foreign governments have filed amicus briefs in support of the foreign-commerce argument made by the plaintiffs. But for the following reasons, the court never reaches the foreign-commerce question.

# I.

## Motion to Reconsider

While these cases were still before Judge Marshall, the Board filed a motion to dismiss in both actions partly founded upon the argument that the foreign parents lacked standing to challenge the tax assessed on their domestic subsidiaries. In reliance on the Seventh Circuit case *Alcan Aluminum Ltd. v. Department of Revenue of the State of Oregon*, 724 F.2d 1294, 1299 (7th Cir. 1984) ("*Alcan II*"), Judge Marshall rejected the Board's stand-

ing argument in the Alcan case and denied the motion.<sup>2</sup> *Alcan Aluminum Ltd. v. Franchise Tax Bd. of the State of California*, No. 84 C 6932, slip op. at 3 (N.D. Ill. January 10, 1985). In its motion for summary judgment, the Board renews its standing argument and asks this court to reconsider the standing issue.

In *Alcan II*, as in these related cases, the foreign parent corporation sought to restrain state tax officials from applying the unitary apportionment method of taxation to a domestic subsidiary. The key distinguishing feature of *Alcan II*, however, was that in that case the state tax officials had not yet assessed the tax on the domestic subsidiary. Judge Kocoras granted the defendant's motion to dismiss in that case based on his ruling that the foreign parent lacked standing to challenge the state action and that the case was not ripe for decision. *Alcan Aluminum Ltd. v. Department of Revenue of the State of Oregon*, No. 82 C 3388, slip op. at 5-7 (N.D. Ill. March 8, 1983), *aff'd*, 724 F.2d 1294 (7th Cir. 1984). In *Alcan II*, the Seventh Circuit affirmed and agreed with Judge Kocoras that the case was not yet ripe for decision because the tax had not yet been assessed. *Alcan II*, 724 F.2d at 1295 & 1299. In so holding, the Seventh Circuit finished its opinion with the following statement:

We express *no views* as to whether [Alcan] will have standing to challenge [the Oregon Department of Revenue's] action if [the Department does] assess AlcanCorp as part of a unitary business including [Alcan].

*Id.* at 1299 (emphasis added).

In his opinion rejecting the Board's standing argument, Judge Marshall relied on the following excerpt from *Alcan II*:

The United States Court of Appeals for the Ninth Circuit, in a case factually similar to the present case, apparently has held that the foreign parent's action is not ripe until a tax has been assessed and the domestic subsidiary has exhausted its state remedies. *Shell Petroleum, N.V. v. Graves*, 709 F.2d 593, 597 (9th Cir. 1983), *cert. denied*, 464 U.S. 1012

<sup>2</sup> The Board withdrew its motion to dismiss in the Imperial case after this ruling.

(1983). In *Shell*, however, the parent's only alleged injury was as a shareholder of its subsidiary. The parent alleged no apparent injury as a basis for standing. *Id.* at 595. Thus, the subsidiary's state remedy fully protects the parent's interests. The present case is distinguishable. Appellant has alleged an independent injury as a basis for standing. It claims an unconstitutional burden on its foreign commerce. If appellant's allegations as to its standing are accepted as true, its interests and those of AlcanCorp are not identical. (citation omitted). Thus, AlcanCorp's state remedy does not protect appellant fully. As soon as the tax is assessed against AlcanCorp, the threat of injury to appellant will be immediate. Nothing in the Tax Injunction Act requires appellant to wait while AlcanCorp pursues its own remedies under Oregon law for its own injury.

*Alcan II*, 724 F.2d at 1299. Judge Marshall understood this portion of the opinion to be an indication that a foreign parent corporation has standing to challenge the imposition of a tax on its subsidiary when the parent alleges that the tax burdens its foreign commerce. *Franchise Tax Bd.*, slip op. at 2. This court cannot agree. The Seventh Circuit did not make a finding that Alcan had standing in *Alcan II*; instead, it held that once the Oregon tax was assessed on Alcan the case would be *ripe* because at that point Alcan would experience the threat of injury. Consequently, unlike in *Shell*, the foreign parent would not have to wait for the domestic subsidiary to exhaust state remedies for the case to become ripe.

While both ripeness and standing are doctrines derived from general notions of justiciability and at times can involve inquiries that are intermingled, the doctrines are by no means identical. Ripeness is a focus on the *timing* of the lawsuit, particularly whether the alleged injury has become mature. See 13 C. Wright, A. Miller & E. Cooper, *Federal Practice and Procedure: Civil* ¶ 3531, at 350 (1984). The doctrine of standing is not a focus on the timing of the lawsuit but rather on the *party* who brings the suit. *Id.*, § 3531, at 339. In fact courts frequently deny stockholders such as Alcan or Imperial standing to sue even though it is clear that the stockholder has already been injured because the

injury is an indirect result of an injury to the corporation. See *Twohy v. First Nat'l Bank of Chicago*, 758 F.2d 1185, 1194 (7th Cir. 1985); *Club Assistance Program, Inc. v. Zukerman*, 594 F. Supp. 341, 348 n.15 (N.D. Ill. 1984) (Shadur, J.). Stated alternatively, those courts made the finding that the plaintiffs in those suits did not have standing to sue even though those cases were ripe for decision.

Moreover, this court cannot ignore the Seventh Circuit's explicit statement in *Alcan II* that the ruling was based solely on the ripeness question and that it expressed no view on the question of whether Alcan would have standing once tax was assessed. *Alcan II*, 724 F.2d at 1299. Even assuming Alcan and Imperial are correct in their argument that the Seventh Circuit did express its views on the standing issue, such an expression would be obiter dictum in light of the court's ripeness ruling and hence not binding on this court. Therefore regardless of which interpretation of *Alcan II* this court adopts, the court must confront the standing issue directly.

## II.

### Standing to Sue

Under general principles of corporate law, stockholders of a corporation have no personal or individual right of action against third persons for damages that result indirectly to the stockholders because of an injury to the corporation. *Twohy*, 758 F.2d at 1194. Applying this principle in circumstances virtually identical to those here, courts in three different circuits have found that a foreign parent corporation does not have standing to challenge the tax assessment of that corporation's domestic subsidiary. *EMI Ltd. v. Bennett*, 738 F.2d 994, 996-99 (9th Cir. 1984), *cert. denied*, 469 U.S. 1073 (1984); *Shell Petroleum, N.V.*, 709 F.2d at 595-96; *Alcan II*, slip op. at 5-6 (Kocoras, J.); *Alcan Aluminum Ltd. v. Franchise Tax Bd. of the State of California*, 558 F. Supp. 624, 629 (S.D. N.Y. 1983), *aff'd*, No. 83-7236 (2d Cir. June 17, 1983), *cert. denied*, 104 S.Ct. 1457 (1984). Moreover, in his concurrence in *Simon v. Eastern Kentucky Welfare Rights Org.*, 426 U.S. 26 (1976), Justice Stewart stated the following:

I add only that I cannot now imagine a case, at least outside the First Amendment area, where a person whose tax liability was not affected ever could have standing to litigate the federal tax liability of someone else.

*Simon v. Eastern Kentucky Welfare Rights Org.*, 426 U.S. 26, 46 (1976) (Stewart, J., concurring). Justice Stewart's statement is equally applicable to state tax liability.

Because the foregoing cases adequately state the grounds for the finding that Alcan and Imperial have no standing, this court will not belabor the point here. Suffice it to say that the domestic subsidiaries can raise the foreign-commerce claim in suits which they bring and that authority exists for the proposition that the United States itself can bring suit to challenge the burden on foreign commerce. See *United States v. Solomon*, 563 F.2d 1121, 1126-29 (4th Cir. 1977) (cases cited therein). Furthermore, the demands for information which both Alcan and Imperial complain of were made to the domestic subsidiaries, not to Alcan or Imperial. Even if those demands constituted a basis for standing, it would be for the limited purpose of attacking the demands themselves rather than the tax liability of those domestic subsidiaries. See *EMI Ltd. v. Bennett*, 560 F. Supp. 134, 136 (N.D. Cal. 1982), *aff'd*, 738 F.2d 994 (9th Cir. 1984), *cert. denied*, 469 U.S. 1073 (1984).

### Conclusion

The court grants the Board's motion for summary judgment in both the Alcan and the Imperial cases. Both cases are dismissed.

ENTER:

/s/ ANN CLAIRE WILLIAMS

Dated: JUL 29 1987

**Appendix C**

(Filed June 17, 1983)

83-7236

**UNITED STATES COURT OF APPEALS**

For the Second Circuit

At a stated Term of the United States Court of Appeals the Second Circuit, held at the United States Courthouse, City of New York, on the 17th day of June One Thousand Nine Hundred and Eighty-three.

**PRESENT:**

Hon. Ellsworth A. Van Graafeiland,

Hon. Lawrence W. Pierce

Hon. John Minor Wisdom,\*

Circuit Judges

**ALCAN ALUMINUM [SIC] LIMITED,**

Plaintiff-Appellant,

**THE FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA**, operating through its New York Office; **FRANK GOODMAN**, individually and as District Manager, New York Office of the Franchise Tax Board of the State of California; and **JOSEPH E. GEORGHEGAN [sic]**, Individually and as Supervisor—Audit Group, New York Office of the Franchise Tax Board of the State of California,

Defendants-Appellees.

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\* Senior Circuit Judge of the Fifth Circuit, sitting by designation.  
N.B. Since this statement does not constitute a formal opinion of this court and is not uniformly available to all parties, it shall not be reported, cited or otherwise used in unrelated cases before this or any other court.

**ORDER**

Alcan Aluminum [sic] Limited appeals from a judgment of the United States District Court for the Southern District of New York (Goettel, J.) dismissing its complaint against the Franchise Tax Board of the State of California and two of its New York office employees. We find appellant's contentions without merit and affirm substantially for the reasons stated in the opinion of the district court reported at 558 F. Supp. 624.

/s/ E. A. Van Graafeiland

/s/ L. W. Pierce

/s/ John Minor Wisdom

2  
No. 22-1400

FILED

NOV 22 1988

U.S. COURT OF APPEALS, 9th  
CIRCUIT

In The

**Supreme Court of the United States**

**OCTOBER TERM, 1988**

**FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA; LEONARD  
WILSON, individually and as District Manager, Chicago  
Office of the Franchise Tax Board of the State of California;  
and R. M. BARBER, individually and as Auditor, Chicago  
Office of the Franchise Tax Board of the State of California,  
*Petitioners,***

**v.**

**IMPERIAL CHEMICAL INDUSTRIES PLC,  
*Respondent.***

**ON PETITION FOR A WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS  
FOR THE SEVENTH CIRCUIT**

**RESPONDENT'S BRIEF IN OPPOSITION**

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## **COUNTER STATEMENT OF QUESTIONS PRESENTED**

1. Whether a foreign corporation that is denied access to State courts to present claims of independent injury arising from the acts of a State revenue authority also should be denied standing to present its claims of independent injury in federal court.

2. Whether, a foreign corporation that has standing in federal court to present claims of independent injury arising from the acts of a State revenue authority is nonetheless barred by the Tax Injunction Act (28 U.S.C. § 1341) in the absence of a State remedy.

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No. 88-1400

IN THE

**Supreme Court of the United States**

OCTOBER TERM, 1988

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA; LEONARD WILSON, Individually and as District Manager, Chicago Office of the Franchise Tax Board of the State of California; and B. M. RARANG, Individually and as Auditor, Chicago Office of the Franchise Tax Board of the State of California,  
*Petitioners,*

v.

IMPERIAL CHEMICAL INDUSTRIES PLC,  
*Respondent.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS  
FOR THE SEVENTH CIRCUIT

**RESPONDENT'S BRIEF IN OPPOSITION**

Respondent Imperial Chemical Industries PLC ("Imperial")<sup>1</sup> opposes the Petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit remanding this case and the related case of *Franchise Tax Board v. Alcan Aluminium Ltd* to the United States District Court for the Northern District of Illinois for further proceedings.

**INTRODUCTION**

The district court's dismissal of the two related cases below and the court of appeals reversal and remand were made on the pleadings without consideration of the extensive factual records that had been stipulated. The court of appeals

<sup>1</sup>The names of corporations affiliated with Imperial that are not wholly-owned subsidiaries are listed in Appendix 1.

decision for which review by this Court is sought is not, therefore, final. An interlocutory decision should not be reviewed where, as here, it does not pose a serious and unsettled question of law the resolution of which is fundamental to further proceedings ordered by the court of appeals. It is only after such further proceedings are held that a decision on the merits based on a complete record will be rendered. Until that time, the Petition is premature and should be denied.

### COUNTER STATEMENT OF THE CASE

Imperial filed a complaint on 17 October 1984 in the United States District Court for the Northern District of Illinois against the Petitioners, the Franchise Tax Board of the State of California and the manager and auditor of their Chicago office ("Board"), seeking declaratory and injunctive relief in respect of California income tax assessments.<sup>2</sup> A complaint seeking similar relief had been filed in the same court on 10 August 1984 by Alcan Aluminium Ltd ("Alcan") alleging different facts than the Imperial complaint.<sup>3</sup> The Board filed separate motions to dismiss each complaint on the ground that neither plaintiff had standing to maintain its action in federal court.

On 10 January 1985 the district court (Judge Marshall) ruled that Alcan's allegations, if proven, would confer standing and ordered the Board to file an answer.<sup>4</sup> On 29 January 1985 the Board withdrew their motion to dismiss Imperial. On the same date the district court entered a "finding of relatedness" between Imperial's and Alcan's cases and assigned both cases to Judge Marshall. No order of consolidation pursuant to F.R.Civ.P. 42 was ever issued. The Board thereafter filed a separate answer to each complaint. Each case was reassigned on 19 June 1985 to Judge Williams.

<sup>2</sup>*Imperial Chemical Industries PLC v. Franchise Tax Board*, No. 84-C-8906.

<sup>3</sup>*Alcan Aluminium Ltd v. Franchise Tax Board*, No. 84-C-6932.

<sup>4</sup>Memorandum opinion, Appendix 2.

Separate agreements were reached between the Board and each plaintiff that each case would be submitted on a fully stipulated record without oral testimony. The joint stipulation in Imperial's case was filed 2 December 1985.<sup>5</sup> On 3 February 1986 Imperial filed a motion for summary judgment together with the summary statement of facts required by district court rule 12(e) to be filed by each party to a civil action. Imperial's summary statement requested the district court to make findings of fact from the record. The Board responded on 28 March 1986 by filing a cross motion for summary judgment specifically requesting reconsideration of the prior ruling on standing and making an additional claim that the action was barred by the Tax Injunction Act, 28 U.S.C. § 1341.<sup>6</sup> The Board did not request findings of fact. Similar motions were filed in the related (*Alcan*) case.

On 30 July 1987, the district court reversed the prior order respecting standing and granted the Board's motion in each case to dismiss for lack of standing. No ruling was made in respect of the Tax Injunction Act. The district court's opinion makes no findings of fact; makes no reference to the record; and apparently bases the decision solely on the pleadings.<sup>7</sup>

Imperial and Alcan each filed separate appeals to the United States Court of Appeals for the Seventh Circuit. Imperial's appeal maintained that its complaint alleged independent injuries to Imperial and that the district court failed to consider whether facts of record sustained those allegations. The Board argued that because each appellant was

<sup>5</sup>Imperial's stipulation consists of 20 pages of text with approximately 950 pages of exhibits without agreement between the parties as to relevance or materiality of the exhibits. Alcan's stipulation contains 40 pages of text and more than 1,000 pages of exhibits. The facts in *Alcan* are materially different from those adduced in *Imperial*.

<sup>6</sup>The district court declined to rule on Imperial's objection ("Plaintiff's Reply to Defendant's Cross Motion" filed 3/28/86) that this motion was untimely under F.R.Civ.P. 60(b).

<sup>7</sup>Petition, pp. A-25—A-27. In granting the Board's motion for reconsideration of the prior standing ruling, the district court made no reference to the stipulated records. The memorandum opinion deals entirely with the right of stockholders to maintain actions for injury to their corporation.

merely a shareholder of a taxpayer corporation, it had no standing *in limine* to raise objections to California taxes in either federal or State courts.

The court of appeals found that both appellants had "alleged injuries resulting from California's franchise tax that are sufficiently direct and independent of the injuries to their subsidiaries to confer standing."<sup>8</sup> Absent findings of fact by the district court, each case was remanded for further proceedings, presumably to make findings of fact from the record and to make conclusions of law.<sup>9</sup> The Board thereupon filed their Petition for certiorari with this Court.

#### REASONS WHY THE PETITION SHOULD BE DENIED.

1. *Review of the interlocutory decision below is not warranted.* The Petition seeks review of an interlocutory decision by the court of appeals. No final decision on the merits has been made nor can be made until the district court conducts further proceedings as ordered by the court of appeals. Absent extraordinary circumstances, a writ of certiorari should not issue until a final decision on the merits is rendered on a complete factual record.<sup>10</sup> Where a case is remanded by a court of appeals for further proceedings, certiorari is usually denied because the case "is not yet ripe for review by this Court."<sup>11</sup>

Exceptions to this principle of certiorari jurisdiction over interlocutory orders are few. Review of an interlocutory order should only occur where a "serious and unsettled" question of law is presented.<sup>12</sup> Even where such a question

<sup>8</sup>Petition A-20.

<sup>9</sup>It is not unusual in tax cases to proceed to judgment on partially or fully stipulated records. See TAX COURT RULES 122 and 90(a). A fully stipulated record should not relieve a trial court from examining evidence adduced, hearing argument, and deciding what is relevant and material as well as what inferences are to be drawn from facts of record to support findings of fact and conclusions of law.

<sup>10</sup>*Hamilton-Brown Shoe Co. v. Wolf Bros. & Co.*, 240 U.S. 251, 258 (1916).

<sup>11</sup>*Brotherhood of Locomotive Firemen & Enginemen v. Bangor & Aroostook R.R.*, 389 U.S. 327, 328 (1967).

<sup>12</sup>*Nixon v. Fitzgerald*, 457 U.S. 731, 743 (1982).

of law is presented, review is generally denied unless resolution of the question is "fundamental to the further conduct of the case."<sup>13</sup>

Analysis of those cases that have granted certiorari for interlocutory orders demonstrates the narrow limits this Court has placed on such review. Certiorari has been granted to review a court of appeals remand involving scope and application of the Constitution's "just compensation" requirement to leasehold property (then an issue of first impression) resolution of which was necessary to delineate the scope of additional proceedings.<sup>14</sup> Certiorari was similarly granted to review and affirm a court of appeals remand for hearing on the merits in order that this Court could establish guidelines to distinguish between claims against officers of the United States for unauthorized actions and claims against the United States itself.<sup>15</sup> Further clarification of the distinction between a tort claim against a public official and a claim that impleaded the sovereign was also the reason for granting certiorari to review a court of appeals remand for trial.<sup>16</sup>

These three cases demonstrate that certiorari under 28 U.S.C. § 1254(1) to review an interlocutory order is granted only when there is some compelling principle of law that needs to be clarified *without regard to findings of fact*. This principle underlay grant of the writ in *Gwaltney of Smithfield v. Chesapeake Bay Foundation*.<sup>17</sup> A court of appeals, contrary to two other courts of appeals, had read the Clean Water Act<sup>18</sup> to permit a civil suit to continue where the pollution had ceased prior to filing the suit. There was no *fact* issue respecting cessation.

<sup>13</sup>*United States v. General Motors Corp.*, 323 U.S. 373, 377 (1945).

<sup>14</sup>*Id.*, n. 13 *supra*.

<sup>15</sup>*Land v. Dollar*, 330 U.S. 731 (1947). This Court noted that "this is the type of case where the question of jurisdiction is dependent on the decision of the merits." *Id.* at p. 735.

<sup>16</sup>*Larson v. Domestic & Foreign Commerce Corp.*, 337 U.S. 682 (1949). Because this Court found that the cause of action was against the United States itself, and this determination did not depend on the facts alleged, the complaint was ordered dismissed.

<sup>17</sup>484 U.S. —, 108 S. Ct. 376 (1987).

<sup>18</sup>33 U.S.C. § 1365(a).

In light of these principles, the court of appeals decision that Imperial's allegations of independent injury are sufficient to confer standing does not pose a serious and unsettled question of law. This Court should not be imposed upon to make original findings of fact from an extensive record as implicitly required by the Petition.<sup>19</sup>

(a) *No conflict of law exists among the circuits.* The Board argue that the decision of the Seventh Circuit in this case conflicts with decisions in the Ninth and Second Circuits.<sup>20</sup> The different results, however, appear to arise from differences in allegations of facts, not differences in legal principles. This Court should not be petitioned to resolve differences in result where there are virtually no facts of record in any of the cases cited to demonstrate the putative conflict. Certiorari was denied by this Court in all three precedents cited by the Petition none of which had complete factual records.<sup>21</sup>

Each of these precedents involved standing of a foreign parent-shareholder to contest a worldwide, combined income apportionment and tax assessment. In each case, the court found that the parent-shareholder had no interest in the subject matter other than as a shareholder of a domestic taxpayer. Each court believed this was insufficient to give the parent separate standing to contest the taxes assessed. Each case was decided on a motion to dismiss by reference to pleadings or affidavits without evidentiary hearing or

<sup>19</sup>This Court granted certiorari and then dismissed "for want of a substantial federal question" in *Chicago Bridge & Iron Co. v. Caterpillar Tractor Co.*, 454 U.S. 102 (1981), dismissed 463 U.S. 1220 (1983), apparently because the case was not in an appropriate posture to give adequate consideration to the significant issues arising from Illinois' application of worldwide combined income apportionment for taxation. This Court later heard and decided *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983), when similar issues were presented but on a complete record with findings of fact, appellate review, and the proper parties.

<sup>20</sup>Petition, pp. 7-8.

<sup>21</sup>*EMI Ltd. v. Bennett*, 738 F.2d 994 (9th Cir.), cert. denied, 469 U.S. 1073 (1984); *Alcan Aluminum Lim.*, 742 F.2d 1430 (2d Cir. 1983), affirming without opinion 558 F. Supp. 624 (S.D.N.Y.), cert. denied, 464 U.S. 1041 (1984); *Shell Petroleum, N.V. v. Graves*, 709 F.2d 593 (9th Cir. 1983), cert. denied sub nom., *Shell Petroleum N.V. v. Franchetti*, 464 U.S. 1012 (1983).

stipulation of facts. The limited facts recited in the three cited decisions compared with the allegations, to say nothing of the extensive record, in the instant case demonstrate why certiorari is no more appropriate in the instant case than it was in these precedents.

The first of the precedents to be decided was *Shell*, upon the authority of which the other two relied. The foreign parent, who together with its domestic subsidiary faced a large, proposed, worldwide, combined income assessment based on failure to disclose information that only the foreign parent could provide, sought a declaratory judgment. The gravamen of the complaint was an alleged treaty violation.<sup>22</sup> *Shell's* complaint was dismissed for both lack of ripeness and lack of standing.<sup>23</sup> As to standing, the court held that the treaty did not give a foreign corporation any rights that a domestic corporation would not have and that "[the] method of taxation that [Shell] seeks to enjoin does not injure [Shell] directly or independently . . ."<sup>24</sup> The court in *Shell* clearly viewed the complaint as a challenge to the method of income apportionment in the abstract. The court did not consider in the *Shell* opinion the cost of compliance; actual or threatened double taxation; the effect the method of tax might have on the parent company's foreign commerce with the United States; nor the federal government's position on the issue presented.

Whether the plaintiff in *Shell* alleged an independent injury is not entirely clear. The significant point is that both the district court and the court of appeals believed that the parent corporation did not allege an independent injury and assumed that it did not sustain an independent injury.<sup>25</sup>

<sup>22</sup>Treaty of Friendship, Commerce and Navigation, 27 March 1956, United States—Netherlands, 8 U.S.T. 2043, T.I.A.S. No. 3942.

<sup>23</sup>The Seventh Circuit Court of Appeals has similarly dismissed a foreign parent-shareholder suit for lack of ripeness, while suggesting there might be standing if the parent could prove independent injury. *Alcan Aluminium Ltd. v. Oregon Dept. of Rev.*, 724 F.2d 1294 (7th Cir. 1984).

<sup>24</sup>709 F.2d 593, 595.

<sup>25</sup>*Ibid.* The district court (but not the court of appeals) referred to *Shell's* contentions that "the California apportionment method . . . is repugnant to [the Constitution] . . . violates [the treaty] . . . and violates 'general principles of international law'." *Shell Petroleum, N.V. v. Graves*, 570 F. Supp. 58, 60 (N.D. Cal. 1983). The district court believed these general allegations directed to the method of income apportionment fell short of alleging independent injury to the parent company.

The second case is *EMI*. EMI's U.S.A. subsidiary, Capitol, had filed an action in federal court contesting a worldwide, combined income apportionment and informational demands that could only be met by Capitol's foreign parent, EMI. Capitol's action was dismissed because of the Tax Injunction Act.<sup>26</sup> EMI's separate action was dismissed for lack of standing because the court found EMI had no interest other than as a shareholder. The court of appeals stated, "[t]his case is controlled by [*Shell Petroleum v.*] *Graves*. The facts in *Graves* are nearly identical to those presented here."<sup>27</sup> EMI's complaint, similarly to *Shell*'s, relied on a treaty.<sup>28</sup> EMI, in addition, alleged that United Kingdom law prohibited the disclosure of some information demanded by the Board. The court, however, found EMI's essential complaint to be diminution of value of its United States subsidiary and legality of the "unitary" tax method itself.<sup>29</sup> The court held neither of these grounds sufficient to confer standing on a shareholder. As in *Shell*, the *EMI* decision mentioned no facts concerning double taxation and none about costs of compliance nor burdens on foreign commerce. The federal government did not file a position in the case. The *EMI* case is far removed from the specific facts alleged by Imperial.

The *Alcan* case also did not consider a full record. The opinion expressly follows *Shell* in finding there was no standing for a foreign parent to challenge the unitary tax method. The court stated that the facts were "strikingly similar" to *Shell* and the district court decision in *EMI*.<sup>30</sup> The court recognized, however, "... that the fact that [Alcan's] subsidiary has a remedy and standing is no reason for this Court to deny standing to [Alcan]. This would be true if [Alcan] had a valid independent basis for standing."<sup>31</sup> But

<sup>26</sup>28 U.S.C. § 1341.

<sup>27</sup>738 F.2d 994.

<sup>28</sup>United States—United Kingdom Income Tax Convention of 1946, 60 STAT. 1377-97 (26 June 1946).

<sup>29</sup>738 F.2d 994, 996-997. Worldwide, combined income apportionment for taxation is generally called "unitary" taxation.

<sup>30</sup>558 F. Supp. 624, 628.

<sup>31</sup>558 F. Supp. 624, 627.

the *Alcan* court rested the decision on the same ground as did the courts in *Shell* and *EMI*, that diminution in value of the parent's domestic subsidiary would not suffice to establish an independent cause of action for a stockholder. As in the other two cases, there was no consideration of double taxation; no consideration of compliance cost; no consideration of foreign commerce burden; and no consideration of the federal government's position.

The fact that a subsidiary corporation has its own cause of action should not deprive its shareholder of a separate cause of action simply because both causes arise from related circumstances. The shareholder must, of course, allege and prove its separate injury and prove that the relief sought will benefit it separately. That is the only legal principle enunciated by the decision of the [Seventh Circuit] court below. The general proposition of law upon which the decisions in *Shell*, *EMI*, and *Alcan* rest is not disputed: A shareholder cannot maintain an action for an injury solely to a corporation in which it is an investor in the Seventh Circuit anymore than it can in the Ninth or Second Circuits. The difference between the instant case and *Shell*, *EMI*, and *Alcan* is clearly demonstrated by contrasting the *direct* injuries alleged by Imperial with the *indirect* injuries referred to by the courts in the three cited cases. The direct injuries complained of by Imperial are: (1) The burden imposed by the cost and difficulty of compliance, which *must be borne solely by Imperial*; and (2) the burden of double taxation, which *is borne solely by Imperial*. The United States Government filed as *amicus curiae* in the district court in support of Imperial's claims of injury by reason of California's unitary method. Numerous foreign governments<sup>32</sup> also filed appearances to object to application of California's unitary method to foreign nationals.

If a conflict exists between *Shell*, *EMI*, or *Alcan* and the decision of the court below in this case, it is a difference in

<sup>32</sup>Australia, Canada, Japan, Switzerland, United Kingdom, and The Member States of the European Economic Community (Belgium, Denmark, France, Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, and United Kingdom).

perception only of facts alleged, not principles of law applicable to facts established in a court of original jurisdiction. The court of appeals, below, acknowledged a possible conflict when they stated, "Insofar as the Ninth Circuit's decisions in *Shell Petroleum, N.V.* and *EMI Ltd.*, may conflict with our holding, we are not persuaded to follow them"<sup>33</sup> [Emphasis added]. Resolution by this Court of any arguable conflict is entirely premature until a conflict clearly appears in the decisions of the lower courts. It cannot develop until the full record has been examined and analyzed by the lower courts. The uncertain nature of such a conflict is not one of such importance to the administration of federal law that it need be resolved by this Court at this time. No legal or factual argument available to the Board will be foreclosed by the district court's consideration of Imperial's claims on the facts and the law. If the facts do not support Imperial's position, the standing issue is moot. But if the facts demonstrate there is injury to Imperial's commerce with the United States, the court of appeals decision below holds there is standing. This is the only legal principle actually developed at this time and it does not appear to conflict with any enunciated in other circuits.<sup>34</sup>

(b) *The Tax Injunction Act does not bar Respondent's action.* The Tax Injunction Act, 28 U.S.C. § 1341, is not an issue. The Petition cites only that Act under "Statutory Provisions Involved" and devotes fully one quarter of its argument to the philosophy and rationale of the Act. But the complete rebuttal to that argument is stated in the Petition itself. In castigating the court of appeals for their suggestion that California could avoid intrusive federal litigation by providing a foreign corporation with a State remedy, the Board expostulates: "In other words, as the sole stockholders of their respective subsidiaries, both of the parent companies effectively have state remedies to pursue."<sup>35</sup>

<sup>33</sup>Petition, A-1, n., A-17, n. 12. See also the court's discussion of *Shell, EMI*, and *Alcan* at A-12, A-13, and A-14.

<sup>34</sup>See, discussion of standing principles in *The Presbyterian Church (U.S.A.) v. United States*, \_\_\_ F.2d \_\_\_, 89 C.D.O.S. 1849, 1850-51 (9th Cir. No. 86-2860, 3/15/89).

<sup>35</sup>Petition, p. 22.

It is undisputed that Imperial cannot contest its subsidiary's taxes in the California courts nor, under the Board's view, is Imperial permitted access to California courts to present claims concerning direct injuries.<sup>36</sup> Not only is there no "plain, speedy, and effective remedy" in California courts, there is no remedy at all.<sup>37</sup> This very point, with an admonition similar to that from the Seventh Circuit, was also made by the Ninth Circuit seven years ago.<sup>38</sup>

The court of appeals, below, completely answered the Board's "heads we win, tails you lose" jurisdictional posture vis-a-vis the Tax Injunction Act when they ruled: "We hold that comity and federalism, weighty as these concerns are where federal courts pass on the constitutionality of state tax legislation, cannot justify withholding federal jurisdiction from a party with no cause of action in state court to redress its own independent injury."<sup>39</sup> Respondent, Imperial, cannot add anything to the clarity and logic of that statement.

(c) *There is no interference with further proceedings.* The court of appeals did not and this Court does not have the benefit of a district court's findings of fact or conclusions of law from a voluminous record. Both the district court's judgment and the court of appeals reversal were made on the

<sup>36</sup>Imperial does not maintain a presence in California. This fact distinguishes the instant case from *Barclay's Bank Int. Ltd v. Franchise Tax Board*, No. 32059, Cal. Super. Ct., Sacramento Co., 20 Aug. 1987, now on appeal to the California Court of Appeal. In that case, the foreign parent as well as its United States subsidiary did business in California and thus had standing as a "taxpayer" in California courts. *Barclay's* is the first case in which a foreign parent, itself, has been able to contest the unitary tax method. After careful consideration of an extensive record the trial court held that the method violated the Commerce Clause of the Constitution insofar as the foreign parent was concerned. The legal issues in *Barclay's* are essentially the same as the legal issues on the merits in the instant case.

<sup>37</sup>See Petition, p. 21, n. 11.

<sup>38</sup>*Capitol Industries—EMI, Inc. v. Bennett*, 681 F.2d 1107, 1119 n. 32 (9th Cir.), cert. denied, 459 U.S. 1087 (1982).

<sup>39</sup>Petition, A-19. This Court has similarly held that the Federal Anti-Injunction Act, 26 U.S.C. § 7421(a), which imposes an even more stringent bar than 28 U.S.C. § 1341, does not bar a suit against the federal government when "Congress has not provided the plaintiff with an alternative legal way to challenge the validity of a tax." *South Carolina v. Regan*, 465 U.S. 367, 373 (1984).

pleadings without considering whether facts of record actually supported allegations of the complaint. The decision of the court of appeals, therefore, seeks to put the case in an appropriate posture for judicial consideration on its merits. The Board are not irreparably prejudiced by the decision. They will have the opportunity to make their case in district court and, if aggrieved by that decision, to appeal findings of fact and conclusions of law. This controversy cannot now be resolved other than by a comprehensive review of the record and a determination whether, on that record, Imperial has proven independent injuries. It is only after such determination that the courts should consider whether those injuries impair constitutionally protected rights.

2. *Review of the merits argued by the Petition is premature and inappropriate.* The instant case has never progressed beyond consideration of preliminary issues by the lower courts. The case is not, therefore, appropriately developed for this Court to make the necessary judgments on the important questions of foreign relations, foreign commerce, and federal prerogatives expressly left undecided in *Container Corp.*<sup>40</sup> Despite this lack of development, the Board now argue that the *facts* contained in the district court record rebut the judgment of the court of appeals.<sup>41</sup> While Imperial deems the Board's argument entirely inappropriate for the instant case in its present posture, the errors presented by that argument must be noted, at least briefly.

The Board present the merits of their case by the rhetorical device of restating the opinion below into form of a syllogism, which the Board then complain incorporates an "incomplete major premise" and a "faulty minor premise" to reach an "invalid conclusion."<sup>42</sup> In order to make this

<sup>40</sup>463 U.S. 159, 189, n. 26 (1983).

<sup>41</sup>The Petition makes no less than ten separate references to the stipulations in the district court cases, despite the fact that neither the district court nor the court of appeals made findings of fact or conclusions of law. While the Petition refers (p. 3, n. 2) to the "comprehensive factual record," the Board found it necessary to dispute both facts and inferences to be drawn from those facts in their response to Imperial's summary statement of facts. See Appendix 3.

<sup>42</sup>Petition, pp. 12-13.

argument, the Board assume facts that are not of record and ignore others that are. The points the Board are disputing are not based on findings of fact made by the court below, they are naked assertions that must be resolved by a trial court. If the Board now wish to offer evidence to complete the "incomplete major premise" (the Board's own premise, in reality), the proper forum is district court.

The Board's "minor premise" which they claim to be "faulty" is derived by quoting the court of appeals out of context.<sup>43</sup> The Board admit that if Imperial only *sold* into California through unrelated companies, Imperial would have no *California taxable income* from those sales. By reason of having a subsidiary with payroll and property in California, however, *all of Imperial's sales income everywhere* becomes the apportionment base for taxation by California.<sup>44</sup> The Board should not be heard to argue in this Court the merits of their case for the first time. The Board chose to renew their motion for judgment on the pleadings after having spent over one year negotiating a fully stipulated record with Imperial. Imperial was, indeed, criticized by the Board for even submitting requested findings of fact to the district court.<sup>45</sup> Despite their vigorous opposition to consideration by the district court of facts of record, the Board now select extracts from that voluminous record and assert that these extracts demonstrate the error of the court of appeals decision. But that decision makes clear that if facts of record are not found to sustain Imperial's allegations, there would be no independent injury and, concomitantly, no standing to complain. The court of appeals expressly did not decide whether, assuming independent injury were found, constitutional rights of Imperial had been infringed: "Evaluation of the constitutional significance of this threat in the particular circumstances presented by California's unitary tax must await the district court's assessment of the merits of this

<sup>43</sup>Petition, pp. 12-13, n-7.

<sup>44</sup>This would be true even if Imperial and the subsidiary had no sales in California. CALIFORNIA REV. & TAX. Code §§ 25102, 25121, and 25128.

<sup>45</sup>Defendant's Response to Plaintiff's Summary Statement of Stipulated Facts, Appendix 3 pp. 3-1, 3-2.

appeal. We decide only that the potential for constitutionally significant offense is sufficient to create standing."<sup>46</sup>

The core of the Board's factual argument is their repeated assertion that Imperial is not directly affected by California's tax system or the Board's actions.<sup>47</sup> Having thus declared that Imperial is not a "taxpayer," they proclaim that Imperial has no standing in California courts and no standing in federal courts because Imperial's only interest is that of a shareholder/investor. This argument is wrong for two reasons. First, the burdens imposed on Imperial by the Board are the burdens imposed on a taxpayer: to maintain records, calculate tax, and provide for its payment. Imperial is in substance a taxpayer. The Board in practice—except when it comes to standing—treat *all* corporations within a unitary group as one taxpayer.

The Board's definition of who is a "taxpayer" for procedural and standing purposes directly conflicts with the definition employed when applying the unitary tax method. A like attempt by the Board to misuse their protean definition of "taxpayer" was recently rebuffed by the California State Board of Equalization ("CSBE") who observed: "It is apparent that in all UDITPA provisions dealing with formula apportionment except 25135, the FTB interprets the term taxpayer to mean all of the corporations within the combined unitary group."<sup>48</sup> The Board are similarly trying to define "taxpayer" so as to prevent Imperial's case from being heard *in any court*.

The second error in the Board's logic appears when they declare that Imperial is *merely* a stockholder having only a

<sup>46</sup>Petition A-16, n. 10.

<sup>47</sup>Petition, pp. 10, 11, 13, 21.

<sup>48</sup>*Appeal of Finnigan Corp.*, 88-SBE-022 pp. 159, 162, decided 25 Aug. 1988, Appendix 4, p. 4-4. CALIFORNIA REV. & TAX. CODE § 25135 requires sales of tangible personal property to be treated as California sales for tax purposes if the property is shipped from California and "the taxpayer is not taxable in the state of the purchaser." In *Finnigan*, the Board attempted to apply this provision to out of California sales of a subsidiary corporation by arguing that the subsidiary was *not* a "taxpayer" in those States in which the parent was a taxpayer. The CSBE held that if the parent was a taxpayer in the other State, then the subsidiary was necessarily a taxpayer in the other State as well.

remote interest in the business of its subsidiary, even though, in the Board's own words, "Alcan and Imperial, which have absolute control over their subsidiaries, obviously are in a position to ensure that these remedies are pursued with vigor."<sup>49</sup> It is these elements of control and direct interest in the business of the subsidiary that are the very foundation of California's unitary tax method. The Board wish to have it both ways: Imperial is a taxpayer for purposes of apportioning taxable income; Imperial is not a taxpayer for purposes of contesting that apportionment.

Imperial's action seeks adjudication of its claims based on the law as applied to proven facts. Analysis of those facts will show that Imperial incurs substantial and unreasonable burdens on its commerce with the United States by reason of the Board's administration of California's unitary tax method; that these burdens affect and interfere with prerogatives of the federal government; that the federal government deems California's unitary tax method an interference with foreign commerce and foreign relations of the United States; and that foreign governments have protested California's unitary tax method and have proposed retaliatory measures against United States businesses. The adjudication sought should be made initially by the district court and reviewed by the court of appeal, if necessary. It is only then, if at all, that the instant case will be in a form suitable for presentation to this Court.

<sup>49</sup>Petition, p. 22.

**CONCLUSION**

For the reasons stated, review by this Court of the decision of the Seventh Circuit Court of Appeals remanding Imperial's case to the United States District Court for the Northern District of Illinois for further proceedings is inappropriate. The Petition for Certiorari should be denied.

Respectfuly Submitted,

JAMES MERLE CARTER  
*Counsel of Record*  
JOHN B. LOWRY  
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*Of Counsel:*

MCCUTCHEN, DOYLE, BROWN & ENERSEN

## APPENDIX 1

**CORPORATIONS AFFILIATED WITH IMPERIAL  
CHEMICAL INDUSTRIES PLC<sup>1</sup> THAT ARE NOT  
WHOLLY OWNED SUBSIDIARIES.****Group I—Subsidiaries and Affiliates.**

ACF & Shirley Ltd; Advanced Systems Consultants Limited; AFL Pty Limited; Afrade Pty Limited Agchem Pty Ltd; Agtech Developments (N.Z.) Limited; Alchem Inc.; Alchemie Research Centre (Private) Ltd; Ammonia Company of Queensland Pty Limited; Andrews Lees (NZ) Ltd, Atlas de Mexico, S.A. de C.V.; Atlas Taiwan Corporation; Attivalac S.R.L.; Austral-Pacific Fertilizers Limited; Australian Fertilizers Limited; Australian Sun Research Laboratories Pty Limited; Australian Sun Research Labs, Inc.; Avon Manufacturing Co Limited.

Balm Paints (NZ) Limited; Bay Industries Limited; Berger Paints New Zealand Ltd; BJN (FIJI) Ltd; BJN Holdings New Zealand Ltd; BJN Investments Pty Ltd; BPA Industries Pty Ltd; Brasek Participações Ltda; British Paints (PNG) Pty Ltd; British Paints NZ Ltd.

Catoleum New Zealand Limited; Catoleum Pty Limited; Chemetics do Brasil Comercio & Industria Ltda; Chemical Company of Malaysia Berhad; Chemical Supplies Limited; Chopcair Ltd; Colourmarket New Zealand Ltd; Compagnie Europeenne des Preintures Julien SA; Companhia de Explosivos Valparaiba; Consolidated Fertilizers Ltd; Coopers Animal Health Australia Limited; Coopers Animal Health NZ Limited; CXA Limited.

Dendrite Australia Pty Ltd; Dendrite Corp (NZ) Ltd; Denkemix Inc.; Dulux Holdings Limited; Dulux Papua New Guinea Pty Ltd; Dyechem Finance Limited; Dyes and Chemicals Limited.

<sup>1</sup>Imperial Chemical Industries PLC is a United Kingdom capital stock company whose shares are traded on the London Stock Exchange. Imperial's shares are also listed on the New Stock Exchange in the form of American Depositary Receipts.

Eastern Nitrogen Limited; Ebonex Technologies Inc.;  
Explo Industrias Quimicas e Explosivos S.A.; Explonor Inc.;  
Explosifs Saguenay Inc.

Flex Products Inc.

G F Real Estate Pty Limited; General Fertilisers Limited;  
George Shirleys (NSW) Pty Ltd; Guthrie Bowron & Co  
Ltd.

Hydroline P/L.

I.C. Insurance (Australia) Limited; I.C. Insurance Advisory  
Services Propriety Limited; I.C.I. France S.A.; I.C.I. Paints  
(Malaysia) SDN BHD; ICI Agrochemicals (Malaysia) SDN BHD;  
ICI Alfloc Limited; ICI Asiatic (Agriculture) Company Limited;  
ICI Asiatic Chemicals Co Ltd; ICI Australia Engineering Proprietary  
Ltd; ICI Australia Finance Limited; ICI Australia Investments Pty Ltd;  
ICI Australia Limited; ICI Australia Nominees Pty Ltd; ICI Australia  
Operations Pty Ltd; ICI Australia Petrochemicals Limited; ICI Australia  
Services Pty Ltd; ICI Bangladesh Manufacturers Limited; ICI Biocol  
Limited; ICI C&P France S.A.; ICI Chile S.A.; ICI Diminicana S.A.;  
ICI Dulux Papua New Guinea Pty Limited; ICI Explosives (QLD) Pty;  
ICI Explosives South East Asia PTE Ltd; ICI Fertilizers (Malaysia) SDN Berhad;  
ICI Figi Limited; ICI Industrial Chemicals (Malaysia) SDN BHD;  
ICI Instruments Pty Ltd; ICI Kern; ICI New Guinea Plastics Pty Ltd;  
ICI New Zealand Limited; ICI Paints (Thailand) Limited;

ICI Pakistan Limited; ICI-Pharma Limited; ICI Synchem Limited;  
ICI-Woobang Co., Ltd.; ICIBRA Participações e Comercio Ltda;  
IDAC (Italia) S.R.L.; IEL Limited; Imperial Chemical Industries de  
Centro America, S.A.; Impkemix Americas Holdings Inc.; Impkemix  
Holdings South East Asia PTE Ltd; Impkemix HongKong Limited;  
Impkemix Investments (NZ) Ltd; Incitec Investments Ltd; Incitec Ltd;  
Industrial Containers Ltd; Initiating Explosives Systems Pty Limited;  
Interplastic-Werk Aktiengesellschaft.

J Armando Industria e Comercio de Plasticos Ltda.

K C Chemical Industries P/L; Kaohsiung Monomer Co Ltd;  
Katalco Limited; Kooragang Investments Pty Limited.

Lehard (Trading) Ltd; Lehard Ltd.

Marlborough Bio-Polymers Limited; Max Agriculture SDN BHD;  
Minzimp Exploration Ltd; MODO Chemetics Engineering Ltda.

Nalco South East Asia Private Limited; Nalfleet, Bull and  
Roberts Inc.; Nalfloc Limited; Nalfloc Norge; Newcastle Chemical Co.  
Pty Ltd; Nilcra Ceramics (Europe) Limited; Nilcra Ceramics Inc.;  
Nilcra Ceramics Pty Ltd; Northland Explosives Inc.; Nuclear  
Techniques International (M) SDN BHD; Nuwest Explosives Inc.

Olefines Pty Ltd; ORBEA o de Julio S.A.I.C.; ORBEA Argentina  
Sociedad Anonima.

Pacific Paints Pty Ltd; Papl New Zealand Limited; Philippine  
Explosives Corporation; Polycell Products Pty Ltd; Porcupine Powder  
Company Inc.; Propafilm P/L; PT ICI Farmasi Indonesia; PT ICI  
Pestisida Indonesia; PT Nalco Perkasa; PT Techmaster Well Services  
Indonesia.

Retec Limited; Ruane Investments Pty Ltd.

Sai Tubular Services Limited; Sarkem Limited; Seedkem Pty Ltd;  
Selleys Chemical Co NZ Ltd; Selleys Chemical Co. Pty Ltd;  
Sentinel S.A.; Silenus Instruments P/L; Silenus Laboratorios Pty  
Limited; Societe Europeenne De Mais SA; Society Malgache des  
Laques Valentine; Stahl Asia Trading Private Ltd; Stahl Chemical  
Asia Private Ltd; Stauffer Chem Co (New Zealand) Ltd; Stauffer de  
Mexico; Strauss 9 De Julie S.A.I.C.

Techmaster Well Services (Malaysia) Sun. Bhd; Techmaster Well  
Services Australia Pty Ltd; Tema Chemicals Ltd; Terra Trading Co  
Pty Limited; Tingey's Limited; Tribol S.A.

United Pacific Drilling P/L; UPEC Industries Limited.

Valchem Pty Ltd.

Walpamur Ltd; West African Explosives & Chemicals Limited.

Z-Tech Corporation; Z-Tech Pty Limited; Z-Tech Zirconia Pty Ltd; Zest Products Pty Limited.

#### Group II—Related Companies.

AECI Limited; AFEX Holdings (Proprietary) Limited; Agrocentre Farnham Inc.; Agrocentre St. Hyacinthe Limited; Agrocentre St. Remi Inc.; Agrocentre Vinisol Inc.; Agro Inc.; Albright & Wilson (Australia) Limited; Arabian Polyol Company Limited; Asahi Fluoropolymers Company Limited; Associated Irish Cases Limited; Atic Industries Limited.

Bapco; Barclays de Zoete Wedd Securities (Asia) Ltd; Basic Management Inc.; Belasis Hall Technology Park Limited; Belmont Farm Supply; Besguard Limited; Bessemer Road Management Co. Ltd; Blair International Insurance Ltd; Bluewater Agromart Limited; Boripol; Boyes Explosives (Eastern) Limited; Boyes Explosives Limited; Brussels Agromart Ltd; BXL Bulk Explosives Limited.

Cafchem Limited; Canadian Fracmaster Limited; Canamex, S.A. de C.V.; Canso Chemicals Ltd; Cardinal Farm Supply Limited; C.F. Braun Inc.; CFX Computer Solutions; Chemetics Lavalin Inc.; Chemical Industries (Colombo) Limited; Colombiana de Colina Ltda; Colour Printers Specialist (Singapore) Pte Ltd; Coopers Annual Health (Holdings) Limited; Cornwall Chemicals Limited; Coulter Farm Services, Inc.; Covenant Industries Limited; Covilink Limited; Cuprex Joint Venture.

East-Chem Inc.; Electroclor S.A.I.C. (Abbreviation); Electroquimica Argentina S.A.I.C.; Ellix & Everard PLC; Emirates Explosives (Private) Limited; Enterprise Oil PLC; European Vinyls Corporation Holdings BV.

Fingal Farm Supply Limited; Finlayson House Private Limited; Finicisa Fibras Sinteticas Sociedad SARL.

GBC Scientific Instruments P/L; Garst Research Farms Inc.; Gas Gathering Pipelines (North Sea) Limited; Global

Holonetics Corporation; Grand Falls Agromart Ltd; Grand River Farm Supply Limited.

Hartland Agromart Ltd; Harvex Agromart Inc.; Hiflon Plasticos Avancados Ltda; Hildener Aktienbaugesellschaft; Hispanic Industrial S.L.; Hoegy S Farm Supply Limited.

ICI-Farma S.A.; ICI-Zelita S.A.; IDAC Belgium; I.D. Chemicals Limited; IIE Limited; Innosyl Inc.; Intelligent Systems International Limited; Intermedios Organicos S.A.; Irish Fertilizer Industries Limited.

Kasei-Fiberite Co. Ltd; Kromo S.A. de C.V.

Laurence James Electrical Ltd; L'Environnement Eaglebrook (Quebec) Ltee; Les Engrais Lanaudiere Inc.; Les Explosifs Chretien Ltee; Libra International Insurance Limited; Limpact Industries.

Malpeque Fertilizers Ltd; Maple Farm Supply Limited; Marlow Foods; Max Underhill S Farm Supply Limited; Montrose Chemical Corporation of California; MTM PLC; Munro Fertilizers Ltd.

New Zealand Pharmaceuticals Limited; Nippon Polyurethane Industry Co Ltd; Nurel S.A.

Oakwood Agromart Ltd; Oxford Agropro Ltd.

Phillips-Imperial Petroleum Limited; Phytotech Societe Anonyme; Pigment Manufacturers of Australia Ltd; P.T. ICI Paints Indonesia.

Quimicas Lucava SA; Quimica Stahl Polyvinyl CA.

Recuperados Quimicos LDA; Rock Environmental Limited; Rubicon Inc.

Sabag Inc.; Scotland Agromart Limited; Selbat S.A.R.L.; Serco Lubricantes Metalicos SA; SES Iberica SA; Settingerton S Fertilizer Service Limited; Sidlaw Grain Company Ltd; Sirotherm Inc.; Societe Anonyme Negocitas; Societe du Polyethylene de Fos; Societe Guineenne de Produits Explosifs et

Chimiques (SOPEC); Sprucedale Agromart Limited; Swazi-  
land Agricultural Suppliers (Pty) Ltd.

Teijin Agrochemicals Ltd; Tioxide Group PLC; Tricil  
Limited; Tri-County Agromart Ltd.

Unicorn Plant Breeders Limited; Unisigma G.I.E. de  
Recherche et Selection.

Viniclors A; Vinidex Tubemakers Pty Ltd.

Watford Grain and Feed; West Isle Farm Supply; Weston  
Hyde Products Limited.

128639 Canada Inc.

## APPENDIX 2

IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF ILLINOIS  
EASTERN DIVISIONALCAN ALUMINIUM  
LIMITED,*Plaintiff.*FRANCHISE TAX BOARD  
OF THE STATE OF  
CALIFORNIA, etc., *et al.*,*Defendants.*

No. 84 C 6932

## MEMORANDUM OPINION

Prentice H. Marshall, District Judge

Plaintiff Alcan Aluminium Ltd. alleges that the State of California's worldwide unitary taxation program, administered by defendants, the Franchise Tax Board of the State of California (the Board) and certain representatives of the Board, violates the Foreign Commerce Clause of the United States Constitution. Worldwide unitary taxation imposes a tax obligation based upon the income of all companies the Board determines are engaged in a single or unitary enterprise. Defendants have moved to dismiss on the grounds of collateral estoppel, lack of standing, and abstention.

Plaintiff, a Canadian corporation, owns approximately one hundred subsidiaries outside of the United States. Neither plaintiff nor any of its foreign subsidiaries conducts business in the United States. Plaintiff also owns Alcan Aluminum Corp. (Alcancorp), a New York corporation with its principal place of business in Cleveland, Ohio. Alcancorp conducts business in California and is subject to the unitary business income tax.

The Board maintains an office in Chicago, and the two individual defendants operate out of the Board's Chicago

office. For the purposes of determining AlcanCorp's unitary income, defendants have required plaintiff to provide information relating to the activities of plaintiff's foreign subsidiaries, a requirement which has burdened plaintiff financially. According to the complaint, imposition of the unitary income tax burdens not only AlcanCorp, but plaintiff and its foreign subsidiaries as well.

In 1981 plaintiff sued the Board and certain agents of the Board based upon the unitary income tax applied to AlcanCorp, in the United States District Court for the Southern District of New York. In that action the court held that plaintiff, as a parent corporation, lacked standing to contest the taxation of AlcanCorp, its subsidiary. *Alcan Aluminum Ltd. v. Franchise Tax Board of the State of California*, 558 F. Supp. 624 (S.D. N.Y. 1983) (*Alcan I*). The Second Circuit affirmed the decision, *Alcan Aluminum Ltd. v. Franchise Tax Board of the State of California*, No. 83-7236 (2d Cir. June 17, 1983), and the Supreme Court denied certiorari, 104 S. Ct. 1457 (1984). Defendants argue that the result in *Alcan I* precludes plaintiff from relitigating the standing issue.

The Supreme Court has held that a judgment holding a particular tax assessment invalid does not collaterally estop collection of the same tax in a later year when there has been intervening authority which supersedes or repudiates the original decision. *Limbach v. Hooven & Allison Co.*, 104 S. Ct. 1837 (1984); *Commissioner v. Sunnen*, 333 U.S. 591 (1954). Similarly, collateral estoppel should not bar an action challenging imposition of a tax when there is superseding law.

Since *Alcan I*, the court of appeals for this circuit has indicated that a parent corporation has standing to challenge imposition of unitary business income tax on its subsidiary when the parent alleges that the tax burdens its foreign commerce:

[Parent] has alleged an independent injury as a basis for standing. It claims an unconstitutional burden on its foreign commerce. If [parent's] allegations as to its standing are accepted as true its

interests and those of [subsidiary] are not identical. . . . Thus, [subsidiary's] state remedy does not protect appellant fully. As soon as the tax is assessed against [subsidiary], the threat of injury to appellant will be immediate. Nothing in the Tax Injunction Act requires [parent] to wait while [subsidiary] pursues its own remedies under Oregon law for its own injury.

*Alcan Aluminium Limited v. Department of Revenue of the State of Oregon*, 724 F.2d 1294, 1299 (7th Cir. 1983). The court appeals affirmed the dismissal of the action, however, because the tax had not yet been assessed, and, therefore, the case was not ripe.

To apply collateral estoppel as a bar to this action would mean that companies similarly situated to plaintiff could challenge the tax in this circuit, but that plaintiff could not. Collateral estoppel should not be applied to result in such inequality. Further, there is some authority that collateral estoppel should not be applied in a circuit which has adopted a contrary rule of law. *United States v. Stauffer Chemical Co.*, 104 S. Ct. 575, 582 (1984) (White, J., concurring opinion).

The Seventh Circuit has recognized that if plaintiff's allegations are true, plaintiff suffers an independent injury from the unitary business tax, and therefore, has standing to contest the constitutionality of the tax. Accordingly, collateral estoppel does not bar this action.

Finally, defendants argue that we should abstain from hearing this action while AlcanCorp pursues a refund action in the California courts. Such an action is now pending in the Los Angeles County Superior Court. Defendants assert that the factual determinations made by the California court as to whether plaintiff and AlcanCorp are a unitary business may obviate the need to decide the constitutional issues presented in this action. Plaintiff, however, is not a party to the California action. Because plaintiff is not directly taxed, it has no state remedy to exhaust to gain relief from the tax. The state refund action does not fully protect plaintiff's

interests. Plaintiff's only remedy is to contest the constitutionality of the tax. Consequently, abstention to an action in which plaintiff is not a party is inappropriate.

Defendant's motion to dismiss is denied. Defendant to answer the complaint within twenty days of the entry of this order.

ENTER:

/s/ Prentice H. Marshall

---

Prentice H. Marshall

District Judge

DATED: January 10, 1985

## APPENDIX 3

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Attorneys for all Defendants

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF ILLINOIS  
• EASTERN DIVISION

IMPERIAL CHEMICAL  
INDUSTRIES PLC,

*Plaintiff,*

v.

THE FRANCHISE TAX  
BOARD OF THE STATE OF  
CALIFORNIA, operating  
through its Chicago office, et al.,

*Defendants.*

No. 84-C-8906  
(Judge Williams)

DEFENDANTS'  
RESPONSE TO  
PLAINTIFF'S  
SUMMARY  
STATEMENT OF  
STIPULATED FACTS

Although the parties to this action have executed a Joint Stipulation of Facts (twice supplemented), plaintiff has deemed it appropriate to prepare on its own a "Summary Statement of Stipulated Facts." In doing so, plaintiff has inappropriately paraphrased a number of stipulated facts

and referred to "facts" that are neither recited in the Joint Stipulation of Facts or otherwise reflected in the record. The particular statements in the Summary in which such liberties have been taken are set forth below with defendants' comments.

This response to the Summary prepared by plaintiff is not to be construed as necessarily conceding the materiality of all of the facts recited in the Summary. In addition, defendants' response is not to be construed as conceding either that plaintiff has recited all material facts contained in the Joint Stipulation or accurately characterized or described the additional facts set forth in the stipulated exhibits. The interpretation and significance of the stipulated facts and exhibits are matters to be covered in legal argument. The following comments therefore relate only to those statements of plaintiff that inappropriately paraphrase the facts as stipulated or refer to alleged facts that do not appear in the record.

#### STATEMENT NO. 15

"... the Board recomputed business income subject to California tax by applying the three factor apportionment using as the apportionment base the assumed worldwide income of the ICI Group. Stip. ¶ 14."

##### *Comment:*

The word "assumed" does not appear in paragraph 14 of the Joint Stipulation. The comparable sentence reads: "... the Board recomputed ICI Am's net income subject to California tax by applying the unitary apportionment method of accounting, using as the apportionment base the worldwide income of the ICI Group." See also Stip., ¶ 30, which states that for purposes of this litigation ICI does not contest the factual correctness of the Board's application of the unitary method.

#### STATEMENT NO. 19

"In computing the ICI Group's income apportionable to California, the Board began with the consolidated income of

the ICI Group shown in the financial statements contained in ICI's published annual reports, expressed in pounds sterling. Adjustments based on information contained in the published annual reports were made by the Board purporting to eliminate exchange rate gains and losses and the earning of corporations owned 50 percent or less by ICI. Adjustments were also made by the Board to the earnings of ICI purporting to conform the statements to California tax accounting. The Board eliminated nonbusiness income for 1971-1975. For 1976-1980, however, dividends from 50% or less owned subsidiaries of ICI were included as business income. Stip. ¶ 21."

##### *Comment:*

(1) The opening phrase of this statement obviously is designed to create the impression that the proposed taxes are being asserted against the ICI Group. The opening phrase of paragraph 21 of the Joint Stipulation actually reads: "In computing the income attributable to ICI Am's California activities..."

(2) ICI twice uses the word "purporting." This word does not appear in the stipulated facts.

#### STATEMENT NO. 24

"... Americas believes that increased assessments for years after 1981, including 1983, a loss year for Americas, are likely to be proposed by the Board on the same unitary basis as earlier years. Stip. ¶ 29."

##### *Comment:*

There is nothing in the record with regard to 1983 being a "loss year" for Americas.

#### STATEMENT NO. 25

"... Much of the information requested [from Americas] was not readily available from any source and is outside the scope of ICI's accounting records. Stip. ¶¶ 26 and 31; Stip. Ex. 9."

*Comment:*

This statement is unsupported by the record. Paragraph 26 of the Joint Stipulation merely refers to correspondence between the Board and ICI Am and Paragraph 31, to the annual "T" forms filed by ICI's subsidiaries. Exhibit 9 is a follow-up letter from the Board's auditor to ICI Am.

**STATEMENT NO. 26**

"... The "T" form is the only standard financial report submitted regularly to ICI by its worldwide subsidiaries. Stip., ¶ 31."

*Comment:*

Paragraph 30 of the Joint Stipulation states that the "T" form is the "basic," not the "only," financial report submitted to ICI by its subsidiaries.

Dated: March 27, 1986

Respectfully submitted,

JOHN K. VAN DE KAMP  
*Attorney General of the  
State of California*

/s/ Patricia Streloff

PATRICIA STRELOFF  
Deputy Attorney General  
*Attorneys for all Defendants*

## APPENDIX 4

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIAIn the Matter of the Appeal of }  
FINNIGAN CORPORATION }

No. 85A-623-LB

## Appearances:

For Appellant: Ronald B. Schrotenboer  
Attorney at LawFor Respondent: Paul J. Petrozzi  
Counsel

## OPINION

This appeal is made pursuant to section 25666<sup>1</sup> of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Finnigan Corporation against proposed assessment of additional franchise tax in the amounts of \$18,957 and \$14,537 for the income years 1977 and 1978, respectively. Appellant received refunds for 1976 and 1979 and would be entitled to larger refunds for those years if it prevails. The Franchise Tax Board has agreed to make the appropriate adjustments if necessary.

The issue for determination is whether, in computing the sales factor of the apportionment formula, the Franchise Tax Board (FTB) properly applied the "throw back" rule, thereby treating sales by appellant's wholly-owned subsidiary, Disc Instruments (Disc), to customers located outside of California as California sales.<sup>2</sup>

<sup>1</sup> Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as is in effect for the income years in issue.

<sup>2</sup> A second issue, whether the Franchise Tax Board properly applied the "throw back" rule to sales made by appellant, itself, in foreign countries, has been conceded by appellant.

Appellant, a California corporation, is engaged in a unitary business that manufactures and sells scientific instruments. Appellant conducts its unitary business through various subsidiaries, including Disc, in California, other states, and foreign countries.

During the appeal years Disc, also a California corporation, manufactured and sold a line of sophisticated scientific instruments somewhat different from those of appellant to customers inside and outside of California. Disc maintained its own sales staff and had its own customers. Disc was not taxable in any of those states outside of California into which it made sales although appellant, itself, was taxable in those states.

In computing the sales factor of the apportionment formula, sales of tangible personal property are ordinarily assigned to the state of destination of the goods (the destination rule). (Rev. & Tax. Code, § 25135, subd. (a).) However, such sales are assigned, or "thrown back," to California if the property is shipped from this state and the "taxpayer is not taxable in the state of the purchaser" (the "throw back" rule). (Rev. & Tax. Code, § 25135, subd. (b).)

In computing the sales factor appellant treated Disc's out-of-state sales as non-California sales and applied the destination rule. In order for the destination rule to apply, it must be shown that the "taxpayer" is actually taxable in the state to which the goods were shipped, or the states to which the goods were shipped had "jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not." (Rev. & Tax. Code, § 25122, subd. (b).) The FTB, however, determined that Disc could not show that it was taxable in those states even though appellant, itself, was taxable in those states. Therefore, the FTB concluded that the "throw back" rule was applicable and treated the sales as California sales, thereby including them in the numerator of the sales factor.

The FTB views this case as one simply involving the burden of proof: Appellant agrees that Disc was not actually taxed in any of the states to which sales were made; therefore,

appellant must show that Disc was subject to a net income tax in those states even though no such tax was imposed. Since appellant cannot satisfy its burden of proof by making such a showing, the FTB concludes that it must prevail.

Although appellant makes several arguments in support of its position, we need to consider only one. Appellant argues that the FTB interprets the word "taxpayer" in the "throw back" rule (Rev. & Tax. Code, § 25135, subd. (b)(2)) differently than it does for all other applicable sections of the Uniform Division of Income For Tax Purposes Act (UDITPA). In effect, appellant argues that the FTB applies the "throw back" rule on a separate corporation basis by interpreting the word "taxpayer" in that context to mean each corporation considered separately, while interpreting "taxpayer" in all other UDITPA provisions to mean all corporations in the unitary group. Appellant's conclusion is that the "throw back" rule should also be applied on a combined group basis.

While we find appellant's argument somewhat overbroad, it is, nevertheless, persuasive.

The FTB's response to appellant's argument is that it is bound to follow the definition given in Revenue and Taxation Code section 23037:

Taxpayer means any person or bank subject to the tax imposed under [the Bank and Corporation Tax Law].

Section 23037 is one of several definitional statutes which are all prefaced by section 23030 which provides: "*Except where the context otherwise requires*, the definitions given in this chapter [which includes section 23037] govern the construction of this part." (Emphasis added.) When exploring the thrust of the phrase "[e]xcept where the context otherwise requires," it is instructive to consider the FTB's regulations under UDITPA.

Section 25121, subdivision (a)(1), of the FTB's regulations provides that "[t]he word 'taxpayer' as used in these regulations is the same as defined in section 23037 and the

regulations thereunder." (Cal. Admin. Code, tit. 18, § 25121, subd. (a)(1).) However, the same regulation contains the following phrase: "Any taxpayer subject to the taxing jurisdiction of this state." (Cal. Admin. Code, tit. 18, § 25121, subd. (d).) This phrase strongly suggests that the word "taxpayer" is used in, at least, two sentences; one in which the "taxpayer" is taxable in California, and another in which the "taxpayer" is not taxable in this state. An analysis of the various sections of UDITPA bears this out. Thus, it is apparent that the FTB's regulations have adopted the gloss of section 23030.

It is apparent that in all UDITPA provisions dealing with formula apportionment except section 25135, the FTB interprets the term "taxpayer" to mean all of the corporations within the combined unitary group. (See, e.g., Rev. & Tax. Code, §§ 25129, 25130, 25131, and 25134; see also § 25120, subd. (a).) Any other interpretation would violate basic unitary theory since only separate corporations taxable by this state would be included within the ambit of the apportionment statutes. (See *Edison California Stores, Inc. v. McColgan*, 30 Cal.2d 472 [183 P.2d 16] (1947).) On the other hand, those UDITPA statutes dealing with specific allocation tend to use the term "taxpayer" to mean the specific corporate entity in question. (See, e.g., Rev. & Tax. Code, §§ 25124-25129; see also Rev. & Tax. Code, § 25137 where "taxpayer" is used three times in three lines with two distinct meanings.) Thus, it is apparent that the term "taxpayer" as used in UDITPA is multifaceted.

It, therefore, remains for us to determine how the term is used in Section 25135, subdivision (b)(2). We believe that basic unitary theory requires us to conclude that, as used in section 25135, subdivision (b)(2), "taxpayer" means all corporations within the combined unitary group. To hold otherwise would result in an apportionment formula which produced a different tax effect where the unitary business was conducted by the divisions of a single corporation than where it was conducted by multiple corporations. No difference in principle is discernible in the two situations. The California Supreme Court has told us that as far as unitary theory is concerned the same rule should apply whether the integral

parts of the unitary business are or are not separately incorporated. (*Edison California Stores, Inc. v. McColgan*, supra, 30 Cal.2d at 473, 480.)

Accordingly, since appellant, a member of the unitary group, was taxable in the foreign states at issue, Disc's sales to those states were improperly thrown back to California. Therefore, the determination of the FTB on this issue must be reversed and its action modified.

### ORDER

Pursuant to the view expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Finnigan Corporation against proposed assessments of additional franchise tax in the amounts of \$18,957 and \$14,537 for the income years 1977 and 1978, respectively, be and the same is hereby modified in accordance with this opinion. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 25th day of August 1988, by the State Board of Equalization, with Board Members Mr. Dronenburg, Mr. Carpenter, Mr. Collis, and Mr. Davies present.

<u>Ernest J. Dronenburg, Jr.</u>	Chairman
<u>Paul Carpenter</u>	Member
<u>Conway H. Collis</u>	Member
<u>John Davies*</u>	Member
_____	Member

\*For Gray Davis, per Government Code section 7.9.

(4)  
No. 88-1400

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IN THE

# Supreme Court of the United States

October Term, 1988

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA;  
LEONARD WILSON, Individually and as District Manager,  
Chicago Office of the Franchise Tax Board of the State of  
California; and B.M. Rarang, Individually and as Auditor, Chicago  
Office of the Franchise Tax Board of the State of California,  
*Petitioners,*

vs.

ALCAN ALUMINIUM LIMITED,  
*Respondent.*

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES  
COURT OF APPEALS FOR THE SEVENTH CIRCUIT

## BRIEF FOR RESPONDENT IN OPPOSITION

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I.

### QUESTION PRESENTED

I. Did the Seventh Circuit err in finding, as a matter of law, that the Petitioner's unitary tax on domestic-subsidary, foreign-parent combinations constitutes a tax burden upon Respondent's foreign activities and that Respondent has standing to bring this action which charges that the tax burden violates the Foreign Commerce Clause of the United States Constitution.

### RULE 28.1 STATEMENT

Petitioner is a Canadian corporation and has no United States subsidiaries or related companies that are not wholly owned. Petitioner has no parent corporation.

## II.

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No. 88-1400

IN THE

Supreme Court of the United States

October Term, 1988

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA; LEONARD WILSON, Individually and as District Manager, Chicago Office of the Franchise Tax Board of the State of California; and B.M. Rarang, Individually and as Auditor, Chicago Office of the Franchise Tax Board of the State of California,

*Petitioners,*

vs.

ALCAN ALUMINIUM LIMITED,  
*Respondent.*

ON PETITION FOR WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS  
FOR THE SEVENTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

## **JURISDICTION**

The technical jurisdictional requirements in the petition appear to be adequately set forth except that Petitioner has introduced in its petition a question not appealed to the Seventh Circuit and, therefore, that issue is not justiciable here. Specifically, Petitioner now wishes to argue whether the underlying action in this case is barred by the Tax Injunction Act (28 U.S.C. Sec. 1341) or the principle of comity. That issue was not appealed to the Seventh Circuit; therefore, this Honorable Court does not have jurisdiction thereon.

### CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The constitutional challenge in this case is under the Foreign Commerce and Due Process Clauses of the United States Constitution: "The Congress shall have the power to regulate commerce with foreign Nations and among the several states and with the Indian tribes." Article I §8, cl. 3; "No State shall . . . deprive any person of life, liberty, or property, without due process of law . . ." 14th Amendment.

### STATEMENT OF THE CASE

The majority of the Petitioner's Statement of the Case accurately delineated the history of this lawsuit. However, Respondent disputes the appropriateness of the final paragraph of Petitioner's Statement which speaks to the Seventh Circuit's comments involving the application of the Tax Injunction Act. Though illustrative, those comments were largely gratuitous. As stated hereinabove, the Tax Injunction Act issue was never appealed or argued. Therefore, any comments on the Act by Seventh Circuit are strictly dictum and are not adjudicable here.

## REASONS PETITION SHOULD BE DENIED

### I. DENIAL OF THIS PETITION WOULD ALLOW THE MATTER TO PROCEED ON THE MERITS, PREVENTING FURTHER UNNECESSARY DELAY.

The use of the unitary method of taxation (Worldwide Method of Combined Apportionment "WCA") beyond the boundaries of the United States has been and continues to be a matter of considerable international controversy. This Court's decision in *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 77 L. Ed. 2d 545 (1983), left unresolved the issue as to whether WCA is constitutional as applied to unitary groups headed by foreign parents:

We have no need to address in this opinion the constitutionality of combined apportionment with respect to state taxation of domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries.

77 L. Ed. 2d at 568 n.26.

Since *Container*, numerous foreign parents have sought to challenge the tax. See *EMI Ltd. v. Bennett*, 738 F.2d 994 (9th Cir. 1984) *cert. den.*, 469 U.S. 1073 (1984) and *Shell Petroleum, N.V. v. Graves*, 709 F.2d 593 (9th Cir. 1983) *cert. den.*, 464 U.S. 1012 (1983). Including and until now, all have met with procedural obstacles. Alcan has persisted because of its view that procedural obstacles were not substantive, but rather a series of tactics designed to delay a decision on the merits.

*Alcan Aluminium Ltd. v. Franchise Tax Board*, 558 F. Supp. 624 (S.D.N.Y. 1983), *aff'd mem.*, 742 F.2d 1430 (2d Cir. 1983), *cert. den.*, 464 U.S. 737 (1984), was Alcan's first case before the Federal District Court for the Southern District of New York ("Alcan N.Y."). In

Alcan N.Y., the first issue addressed and ultimately disposed of was that of abstention. The case was dismissed and affirmed on the basis of the lack of standing. In *Alcan Aluminium Ltd. v. Department of Revenue of the State of Oregon*, 724 F.2d 1294 (7th Cir. 1984), the Seventh Circuit again delayed resolution only this time it relied on the doctrine of ripeness. In the instant action, the Seventh Circuit declined to apply the doctrine of standing to further delay resolution of the substantive constitutional issue in this case.

The use by the Courts of the doctrines of abstention, ripeness and standing has long been recognized as mechanisms of delay. Professor Neil K. Komesar, in his article *Taking Institutions Seriously: Introduction to a Strategy for Constitutional Analysis*, 51 U. Chi. L. Rev. 366 (1984), refers to the work of Prof. Fritz Scharpf, who nearly twenty years earlier recognized the use of these doctrines as a response to these perceived limitations:

Scharpf identified three attributes of the judiciary that limit its competence especially in political question cases: limitations on access to information; the need for uniformity of decision; and the need to defer to the wider responsibility of the political branches. One may observe these attributes at work in the foreign relations cases, which Scharpf and others take as paradigmatic of the political question doctrine. . . . Given these limitations, the judiciary is forced to be concerned that it may be doing damage by exposing sensitive information, reducing necessary flexibility, or otherwise producing undesirable results.

Scharpf recognized that the Court could respond to these limitations in several ways other than abstention required by the political question

doctrine. For example, the Court might use such procedural or jurisdictional responses as "standing" or "ripeness" to delay its decision in an effort to clarify the issues or the facts.

*Id.* at 382.

As incredible as it may seem, Alcan started its effort to obtain a judicial resolution of this case in 1981. We are rapidly approaching the ten-year anniversary of the instigation of this litigation! If this Court were to accept this case on the issues presented by the Petitioner, and affirm the Seventh Circuit, it may well be another five years before the substantive issue in this case is finally resolved. We can see no legitimate reason, such as those outlined by Professor Scharpf, that would justify such a result.

## II. DENIAL OF THIS PETITION WOULD CAUSE LITTLE HARDSHIP TO THE PETITIONER.

The Petitioner's appeal to this Court is in the nature of an interlocutory appeal. In fact, had the District Court held that standing was appropriate as it had prior to the appointment of a new judge, the issue would not have been appealable (28 U.S.C. §1292). The policies underlying the prohibition of interlocutory appeal are equally applicable in this case. Moreover, the nature of the proceeding below would result in their being little hardship imposed on the Petitioner.

This case was originally assigned to Judge Prentice Marshall. The Franchise Tax Board of the State of California ("FTB") moved to dismiss based on standing and other theories. Their motion was denied. The parties then undertook to address the merits of the constitutional issue. They agreed that the case could be resolved on stipulated facts. Substantial stipulations were prepared and submitted by the parties. In the interim, this case was transferred from Judge Marshall to Judge Anne Williams who had recently been appointed to the bench.

The merits of the case were submitted to Judge Williams on cross motions for summary judgment. In addition, the FTB had renewed its motion to dismiss for lack of standing as a precautionary measure to insure that the issue was preserved for review by this Court. To everyone's surprise, Judge Williams did not address the merits and dismissed the case for lack of standing.

By denying this petition, this Court would not only achieve the objectives sought by the prohibition against interlocutory appeal, it would not subject the Petitioner to any hardship. The case would be returned to the District Court, which would then be confronted with fully briefed motions for summary judgment. The FTB would have to do nothing, but await the decision of the District Court which it could then appeal to the Seventh Circuit. In short, the only additional work that a denial of this petition would require would be one or two briefs at the Seventh Circuit, which would, in substance, be much like the briefs already filed at the District Court. Therefore, a denial of this petition would pose little hardship on the FTB.

**III. GRANTING THIS PETITION WOULD PRESENT A SUBSTANTIAL HARDSHIP TO ALCAN AND SEVERELY DISADVANTAGE NUMEROUS OTHER FOREIGN PARENTS WHO ARE LOOKING TO THIS CASE FOR A DETERMINATION OF THEIR RIGHTS.**

Respondent has spent nearly a decade attempting to obtain a resolution of a constitutional claim it raises. It has exhausted every reasonable effort to expedite the judicial process. It has avoided the discovery process, usually cited as the bane to efficient judicial administration.

The FTB on the other hand finds delay to its advantage. Delay raises the transaction costs. It gives the FTB an advantage in settlement negotiations with other unitary businesses headed by foreign parents which undoubtedly results in the FTB being able to obtain substantial revenues to which this Court may ultimately hold it was never entitled.

Finally, delay under these circumstances brings disrespect to the justice system.

#### IV. JUDICIAL ECONOMY REQUIRES THAT THIS PETITION BE DENIED.

Since Alcan first raised its constitutional challenge to WCA, it has recognized that the issue of standing and the issue of the merits are fundamentally related concepts. Put another way, if Alcan does not have standing to challenge WCA because its injury is not sufficiently direct, then there can be no foreign commerce challenge even if raised by the U.S. subsidiary. Alcan operates exclusively in foreign commerce. Its U.S. subsidiary does not operate in foreign commerce. If WCA results in impermissible foreign commerce burdens, those burdens must fall directly and exclusively on Alcan.

The Seventh Circuit, in holding that Alcan and ICI have standing, necessarily had to define for itself the nature of the foreign commerce burden. In its view, it is the fact that WCA has the potential to "penalize" the foreign ownership of American assets that gives rise to standing. Having qualitatively defined the injury, the Seventh Circuit left the determination of whether the quantity of injury rose to constitutional significance:

Evaluation of the constitutional significance of this threat must await the district court's assessment of the merits of this appeal. We decide only that the potential for constitutionally significant offense is sufficient to create standing.

*Alcan Aluminium Ltd. v. Franchise Tax Board*, 860 F.2d 688 (7th Cir. 1988); set forth at A16, n.10, Petition for Writ of Certiorari.

Although disclaiming any decision on the merits, the decision on standing necessarily surveyed the panoply of issues that are raised by the merits. In fact, Alcan's brief on the issue of standing and the brief it submitted at the district court on the merits were virtually the same. It makes little sense for this Court to review both the merits and standing separately. It is a far better use of this Court's time and resources to master the numerous stipulations in this case only once for the purpose of resolving both the standing issue and the merits.

**V. THE ISSUE OF STANDING AND THE ISSUE RAISED BY THE PETITIONER CONCERNING THE APPROPRIATE INTERPRETATION OF THE TAX INJUNCTION ACT DO NOT PRESENT SIGNIFICANT AND BROAD ISSUES OF POLICY THAT HAVE GENERAL APPLICATION.**

Perhaps the most compelling reason why this Court should deny this petition is that the issues that the Petitioner seeks to raise have little or no relevance beyond the specific facts of this case. This Court should limit the exercise of its jurisdiction to those issues which are both important and have widespread application. The issues in this petition fail both tests.

The issue of standing and the proper application of the Tax Injunction Act ("Act") presented by this petition have little application beyond the precise facts presented by WCA. In short, they have no application or relevance beyond their application in the WCA context.

For example, the issue involving the Act is almost no issue at all. Except for the aberrational view of one district court (see *EMI, infra*, at p. 4), the doctrine applied by the Seventh Circuit has been uniformly adopted by every district court and every circuit court that has reviewed the issue.

The issue of standing is also unique. Alcan's and ICI's claim to standing is predicated on the direct injury to its own activities in foreign commerce. The doctrine that standing is appropriate because "it burdens foreign companies' decisions to conduct business through subsidiaries operating in California, [and] it threatens to offend this country's trading partners ..." is not a doctrine that is finding wide-spread application. See Opinion, Petition for Writ of Certiorari, A10. Its application is extremely narrow and its importance is limited only to the issue of WCA. For that reason, this Court should not grant Petitioner's request and review these issues outside of their relevant context.

## CONCLUSION

The issue of the constitutional propriety of WCA is a matter of bitter international controversy. It is a matter which should have been resolved years ago. The fact that the Alcan case is only now approaching resolution after almost ten years in the judicial system is a strident commentary on our judicial process. The fact that the FTB has undoubtedly taken enormous financial advantage of the delay is an embarrassment to those of us who cherish a sense of fairness in our judicial system. Petitioner, by this petition, seeks to merely extend its manipulation of the system.

Alcan asks this Court to deny this petition not to deprive the FTB of its right to appeal, but rather to preserve for itself its right to its day in court. There is no compelling policy reason why the issues raised by the FTB need resolution at this time. Considerations of both economy and expediency militate against the piecemeal review that the FTB requests.

For the foregoing reasons, Alcan respectfully requests that this Court deny Petitioner's request that it issue a Writ of Certiorari in this case.

Respectfully submitted,

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MAR 30 1989

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No. 88-1400

**In the Supreme Court**  
OF THE  
**United States**

OCTOBER TERM, 1988

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, et al.,  
*Petitioners,*

VS.

ALCAN ALUMINIUM LIMITED and IMPERIAL CHEMICAL  
INDUSTRIES PLC,  
*Respondents.*

**REPLY BRIEF OF PETITIONERS**

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No. 88-1400

## In the Supreme Court

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*Petitioners,*

VS.

ALCAN ALUMINIUM LIMITED and IMPERIAL CHEMICAL  
INDUSTRIES PLC,

*Respondents.*

## REPLY BRIEF OF PETITIONERS

## Introductory Statement

Respondents' arguments against the granting of the Board's petition for writ of certiorari are basically contradictory. However, the two opposition briefs (hereinafter "Alcan Op." and "Imperial Op.") are basically consistent in one respect. *Neither respondent has made any effort to defend the Court of Appeals' specific holding with respect to standing*—i.e., the holding that respondents suffer direct and independent injuries because California's method of taxation burdens their decisions to conduct foreign commerce through American subsidiaries. Alcan's sole comment is that the Court of Appeals, in holding that the two parent companies have standing, "necessarily had to define for itself the nature of the foreign commerce burden." Alcan Op., at 10. Imperial takes a more drastic approach, its sole comment being that the Court of Appeals' specific finding of independent injury is based on "naked assertions [of fact] that must be resolved by a trial court." Imperial Op., at 13. Thus, while content with the end result of the decision, neither party has supported its essential rationale, the only thing which accounts for the Seventh Circuit's

departure from decisions in previous cases which have ruled that requisite standing is lacking.

### REPLY TO IMPERIAL OPPOSITION

The thrust of Imperial's opposition to the Board's petition is that review of the Court of Appeals' decision on the standing issue would be "premature" at this point because that court has not actually decided the standing issue in Imperial's favor. In other words, with astonishing modesty, Imperial has failed to recognize its victory below; it has failed to recognize that the Court of Appeals has decided that Imperial *does* have the requisite standing to challenge the tax assessments issued against its domestic subsidiary. The decision of the Court of Appeals simply cannot be read any other way. Indeed, in the very first paragraph of its lengthy opinion, the court unequivocally states: "We find that Alcan and Imperial have incurred injuries that are sufficiently direct and independent of the injuries incurred by their subsidiaries to confer standing." App., at A-2.

According to Imperial, however, after some four years of litigation, the parties are virtually right back where they started from. In its view, the standing issue is still open to debate in the lower courts because thus far there have been no findings of fact which support Imperial's claim of independent injury. It says, for example, that the controversy over standing "cannot now be resolved other than by a comprehensive review of the record and a determination whether, on that record, Imperial has proven independent injuries." Imperial Op., at 12. With one exception, the asserted necessity for further factual development is the theme of all of the arguments raised by Imperial in its opposition to the petition.<sup>1</sup> These arguments are briefly discussed below.

<sup>1</sup> The one exception is Imperial's argument regarding the Tax Injunction Act. Imperial dismisses the Act as "not an issue" in the case, Imperial Op., at 10, apparently on the basis that Imperial has no direct remedies in the state courts. It has not responded to the Board's argument that Imperial effectively has state remedies to pursue since, as the sole stockholder of its domestic subsidiary, it has full control over pursuit of the state remedies available to the actual taxpayer. Imperial also has offered no response to the Board's argument that, in any event,

1. *Contrary to Imperial's assertion, its standing does not depend on the resolution of any factual issue.* Imperial characterizes the decision of the Court of Appeals as "interlocutory" and asserts that the Board's petition should be denied because "certiorari . . . to review an interlocutory order is granted only when there is some compelling principle of law that needs to be clarified *without regard to findings of fact.*" Imperial Op., at 5 (emphasis in original). The argument is fallacious for two reasons.

First, the judgment of the Court of Appeals is "interlocutory" in the sense that it does not reach the merits of the constitutional claims that Imperial wishes to adjudicate. The Court has determined, however, that Imperial has standing to litigate those claims. There is, of course, precedent for the Board's position that a grant of certiorari is entirely appropriate in such a situation. For example, one of the leading authorities on standing, *Gladstone Realtors v. Village of Bellwood*, 441 U.S. 91 (1979), involved two cases (consolidated on appeal) that were in exactly the same procedural posture as the cases at hand. The District Court, as in the present cases, had ruled on motions for summary judgment that plaintiffs lacked standing to sue. 441 U.S., at 95-97. On appeal, the Seventh Circuit, as in the present cases, reversed the judgments of the District Court and remanded for further proceedings. *Id.*, at 98. Plaintiffs then sought review in this Court, which granted certiorari "to resolve the conflict between the decision of the Court of Appeals in this case and that of the Ninth Circuit in [*TOPIC v. Circle Realty*, 532 F.2d 1273 (9th Cir. 1976)], and to consider the important questions of standing raised under Title VIII of the Civil Rights Act of 1968." *Id.*, at 98-99. Thus, it is clear that in *Gladstone* this Court did not consider the lower court's decision on standing to be of such an "interlocutory" nature as to preclude the grant of certiorari.

Imperial's argument that the Board seeks a "premature" review of the standing decision in the present matter is also fallacious for another reason: there are no issues of fact pertaining to Imperial's standing which need to be resolved. As previously pointed out, the parties have *stipulated* to the salient facts. Imperial nevertheless contends that factual issues remain because "[t]he district court's

such a suit by a sole stockholder should be precluded under the principles of comity underlying the Tax Injunction Act.

dismissal of the two related cases below and the court of appeals [sic] reversal and remand were made on the pleadings without consideration of the extensive factual records that had been stipulated." Imperial Op., at 1. There is absolutely no foundation for this contention, other than the fact that neither opinion goes so far as to recite any of the stipulations. Furthermore, the Court of Appeals itself evidently believed that it had all of the facts necessary to determine that Imperial *does* have standing.

This brings up another point which cannot go unmentioned. In both the Court of Appeals and in this Court, Imperial has asserted that the Board has vigorously opposed any consideration of the facts of record insofar as they may relate to the standing issue. See, e.g., Imperial Op., at 13. In truth, however, the Board has never urged—either in connection with its cross-motion for summary judgment in the District Court, or in its brief filed with the Court of Appeals, or in its petition for writ of certiorari filed with this Court—that the stipulated facts should be disregarded. Rather, the Board has consistently taken the position that even the stipulated facts do not support the claim that Alcan and Imperial suffer injuries independent and distinct from those of their domestic subsidiaries. Particularly relevant are the stipulations in both cases that (1) all taxes are or will be assessed against the domestic subsidiaries, and (2) all informational requests have been directed only to the domestic subsidiaries. See Alcan Stip., ¶ 52; Imperial Stip., ¶ 27.<sup>2</sup>

2. *Contrary to Imperial's assertion, there is a clear conflict among the circuits.* Three previous cases in the Ninth and Second Circuits have considered the standing of a foreign parent to litigate the tax liability of a domestic subsidiary: *Shell Petroleum, N.V. v. Graves*, 709 F. 2d 593 (9th Cir. 1983), cert. den., 464 U.S. 1012 (1983); *EMI Ltd. v. Bennett*, 738 F. 2d 994 (9th

<sup>2</sup> Imperial also asserts that in the District Court "the Board found it necessary to dispute both facts and inferences to be drawn from those facts in their response to Imperial's summary statement of facts." Imperial Op., at 12. As indicated in App. 3 to Imperial's brief in opposition, the Board merely (1) questioned the propriety of Imperial's unilateral "Summary of Statement of Stipulated Facts," and (2) objected to Imperial's paraphrasing of certain stipulated facts and to its reference to alleged facts not appearing in the record.

Cir. 1984), cert. den., 469 U.S. 1073 (1984); and *Alcan Aluminum Ltd. v. Franchise Tax Board*, 558 F. Supp. 624 (S.D.N.Y. 1983), aff'd mem., 742 F. 2d 1430 (2d Cir. 1983), cert. den., 464 U.S. 1041 (1984). Each case decided the standing issue against the foreign parent, and in each case the foreign parent unsuccessfully sought review by this Court.

Imperial suggests (in line with the dominant theme of its opposition to the Board's petition) that certiorari was denied in those cases because none of them "had complete factual records." Imperial Op., at 6. With curious logic, Imperial concludes that, similarly, certiorari should be denied in the present matter because there *is* an extensive factual record. Imperial Op., at 7 ("The limited facts recited in the three cited decisions compared with the allegations, to say nothing of the extensive record, in the instant case demonstrate why certiorari is no more appropriate in the instant case than it was in these precedents"). But, aside from its strange logic, Imperial plainly has overlooked the fact that in all of the previous cases review was sought of orders dismissing the foreign parents' actions. Since none of the foreign parents had the opportunity to develop more complete factual records after denial of certiorari, it hardly makes sense to surmise that certiorari was denied pending the development of more complete factual records.

Imperial also errs in asserting that the allegations in the present matter are substantially different from, and more extensive than, the allegations of injury in the three previous cases. Particularly difficult to swallow is Imperial's assessment of the *Shell* case, which the other two cases followed. Imperial states that "Whether the plaintiff in *Shell* alleged an independent injury is not entirely clear." Imperial Op., at 7. The Board finds this purported ignorance of what transpired in *Shell* to be impossible to accept, given the fact that one of Imperial's counsel in the present case was also one of the counsel in the *Shell* matter. Presumably, therefore, Imperial is well aware not only of the allegations made in *Shell*, but of the factual record that was before the court.

Be that as it may, reference to the *Shell* file (U.S. Dist. Ct., N.D. Cal., No. C-81-4302-MHP) would disclose that the complaint in *Shell* was 45 pages long, containing 97 paragraphs in all. Needless to say, it did not take 97 paragraphs for Shell to express

only a general dissatisfaction with California's method of taxation, as Imperial suggests. See Imperial Op., at 7, n. 25. Moreover, while it is true that the standing issue in *Shell* was raised by a motion to dismiss, the court also had before it a motion for summary judgment filed by Shell that was supported by affidavits and exhibits numbering hundreds of pages. In short, the standing issue in *Shell* was not decided in a factual vacuum.

Imperial also says that the Court of Appeals' opinion in *Shell* did not discuss "the costs of compliance; actual or threatened double taxation; the effect the method of tax might have on the parent company's foreign commerce with the United States; nor the federal government's position on the issue presented." Imperial Op., at 7. The federal government's position on the merits of Imperial's constitutional claims has no bearing on its standing to litigate those claims, and while the federal government filed a brief on the merits in the District Court it refrained from filing a brief in the Court of Appeals in support of Imperial's position on standing. Furthermore, as Imperial should be fully aware, the other matters mentioned by it (costs of compliance, double taxation, etc.) were all argued in *Shell*. See, e.g., Petition for Writ of Certiorari, *Shell Petroleum, N.V. v. Franchetti, et al.*, Case No. 83-586, at 9-10, 20-24.

3. *Contrary to Imperial's assertion, the Board's attack on the Court of Appeals' finding of independent injury is not an attempt to argue the merits of the controversy.* Imperial states that this case "is not . . . appropriately developed for this Court to make the necessary judgments on the important questions of foreign relations, foreign commerce, and foreign prerogatives left undecided in *Container Corp.*" Imperial Op., at 12. The Board, of course, agrees. Imperial goes on to assert, however, that the Board's attack on the Court of Appeals' finding of an independent injury sufficient for standing purposes is an attempt by the Board to present "the merits of [its] case. . . ." *Ibid.*<sup>3</sup> This is obviously

<sup>3</sup> In the same section of its brief, Imperial criticizes the Board's use of a syllogism to explain the logic of the Court of Appeals' finding of an independent injury, stating in particular that the minor premise quotes the Court of Appeals out of context. Significantly, however, Imperial does not claim that the syllogism inaccurately portrays the Court of Appeals' reasoning.

incorrect. The Board's argument dealing with the independent injury envisioned by the Court of Appeals is directed solely to the standing issue—an issue which *is* ripe for review.

Imperial's final argument is that the Board wishes to have it both ways: for standing purposes, it has "declare[d] that Imperial is *merely* a stockholder having only a remote interest in the business of its subsidiary," Imperial Op., at 14-15 (emphasis in original); for substantive purposes, on the other hand, the Board not only imposes burdens on Imperial which are "the burdens imposed on a taxpayer," but "treat[s] *all* corporations within a unitary business as one taxpayer." *Id.*, at 14 (emphasis in original). Responding to the various elements of this argument in sequence, the Board has never asserted that standing should be denied because Imperial is a "mere" shareholder; rather, its consistent position has been that Imperial is affected only in its capacity as a shareholder since any injuries to it are the indirect result of the taxes levied against its subsidiary. Also incorrect is the assertion that the Board has imposed burdens on Imperial that are typical of the burdens imposed on a taxpayer; as has been repeatedly emphasized, the Board has made no demands on Imperial whatsoever. Finally, Imperial errs in stating that "The Board in practice—except when it comes to standing—treat[s] *all* corporations within the unitary group as one taxpayer." Imperial Op., at 14. As recognized in the administrative opinion cited by Imperial, see Imperial Op., at A-4, the term "taxpayer" as used in the California tax law is "multifaceted." For example, that opinion notes that while some of the statutes applying the unitary formula use the term "taxpayer" to refer to the unitary business as a whole, others use that term to refer only to the specific corporate entity subject to the California tax. In the standing context, it only makes sense to apply the general definition of "taxpayer" provided by section 23037 of the California Revenue and Taxation Code: "[t]axpayer" means any person or bank subject to the tax . . ." Section 23151 of the California Revenue and Taxation Code imposes the tax only upon the "corporation doing business within the limits of" California.

## REPLY TO ALCAN OPPOSITION

The thrust of Alcan's opposition to the Board's petition, in contrast to the opposition presented by Imperial, is that the Court

of Appeals' decision has clearly settled the standing issue in its favor and there should be no further delay in the consideration of the merits of the controversy. In this connection, it takes the federal judiciary to task, stating that "The use by the Courts of the doctrines of abstention, ripeness and standing has long been recognized as mechanisms [sic] of delay." *Alcan Op.*, at 5. This is something like the pot calling the kettle black. The wholly owned subsidiary of Alcan filed its first suit for refund against the Board some 12 years ago—in the early part of 1977. *Alcan Stip.*, ¶ 36, Exh. XIX-1. Instead of having the taxpayer subsidiary pursue that suit for refund, Alcan has spent its time and effort going from one state to another in hopes of finding a receptive federal forum.<sup>4</sup> It is particularly inappropriate under these circumstances for Alcan to complain of delay in the resolution of the constitutional issues involved; these issues could have been litigated in state court proceedings long ago. It is Alcan's own persistence in seeking a federal forum that actually accounts for much of the delay that Alcan finds so objectionable.

Alcan insists, however, that the constitutional issues could not be resolved in the state courts. In its view, if Alcan does not have standing to challenge California's method of taxation as applied to a domestic company with a foreign parent, no one, including its domestic subsidiary, has the standing to do so. It reasons:

"Alcan operates exclusively in foreign commerce. Its U.S. subsidiary does not operate in foreign commerce. If [California's method of taxation] results in impermissible foreign commerce burdens, those burdens must fall directly and exclusively on Alcan." *Alcan Op.*, at 10.

<sup>4</sup> Alcan says: "As incredible as it may seem, Alcan started its effort to obtain judicial resolution of *this case* in 1981. We are rapidly approaching the ten-year anniversary of the instigation of *this litigation*!" *Alcan Op.*, at 6 (emphasis added). The case filed in 1981 was the case in the Second Circuit which was dismissed for lack of standing, *Alcan Aluminum Ltd. v. Franchise Tax Board*, 558 F. Supp. 624 (S.D.N.Y. 1983), *aff'd mem.*, 742 F.2d 1430 (2d Cir. 1983), *cert. den.*, 464 U.S. 1041 (1984) (*Alcan I*). The Board could not, if it tried, present a stronger argument for collateral estoppel than Alcan's own admission that the suit filed in Illinois seeks the same relief as the earlier suit filed in New York.

This reasoning was rejected by the Seventh Circuit, see *App.*, at A-4, n. 4, and similar reasoning was rejected by the District Court in *Alcan I*. See 558 F. Supp., at 628. It is illogical on its face. The California method of taxation either does or does not interfere with Congress' power to regulate foreign commerce. If it does interfere with the congressional power, and thus violates the Foreign Commerce Clause, then obviously the corporate taxpayer which is required to pay the invalid tax has standing to complain about it.

Only two other points raised in Alcan's brief merit comment. In the opening pages, Alcan asserts that the issue involving the applicability of the Tax Injunction Act was not appealed by the Board to the Seventh Circuit, "and therefore that issue is not justiciable here." *Alcan Op.*, at 1. The Board did not "appeal" the issue to the Seventh Circuit because it prevailed in the District Court, where the cases were dismissed solely on standing grounds. The Board nevertheless argued in the Court of Appeals that a decision in favor of standing would invite wholesale avoidance of the Tax Injunction Act. Under these circumstances, the Court of Appeals felt compelled to consider the Act's implications. In any event, it is well settled that the Act limits the jurisdiction of the district courts, *Rosewell v. LaSalle National Bank*, 450 U.S. 503, 522 (1981), and that a challenge to jurisdiction may be made at any stage of the proceedings. *Sipe v. Amerada Hess Corp.*, 689 F.2d 396, 401 (3d Cir. 1982), citing *Insurance Corp. v. Companie des Bauxites*, 456 U.S. 694, 702 (1982).

Alcan finally claims that "the issues that Petitioner seeks to raise have little or no significance beyond the specific facts of this case." *Alcan Op.*, at 12. That, of course, is boilerplate language typically used to discourage the grant of certiorari. In reality, as indicated by the concerns expressed by the numerous states that have joined in an amicus brief supporting California's petition, the decision of the Court of Appeals has broad significance in the area of state tax administration. The decision has held that parent companies have standing in federal court to challenge state taxes levied against their subsidiaries when the imposition of such taxes is dependent upon the form in which they have chosen to do business. There is no apparent reason why this announced rule would be applicable only to foreign parents, or why it would not be applicable to state tax issues which do not involve the unitary

business/formula apportionment method of accounting. The decision also holds that the sole stockholder of a corporation is not barred by the Tax Injunction Act from bringing a federal action to challenge state taxes levied against that corporation, even though, as the sole corporate stockholder, it is perfectly capable of pursuing its objections to the taxes through the state remedies afforded the corporation. Both of these issues—the issue of standing and the issue involving the applicability of the Tax Injunction Act—are weighty concerns which warrant this Court's attention.

### CONCLUSION

For the reasons set forth above and in the Board's petition, it is submitted that the petition for a writ of certiorari should be granted.

March 29, 1989

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No. 88-1400

In The  
**Supreme Court of the United States**  
October Term, 1988

FRANCHISE TAX BOARD,

*Petitioner,*

v.

ALCAN ALUMINIUM LIMITED AND IMPERIAL  
CHEMICAL INDUSTRIES PLC,

*Respondents.*

On Petition From The United States Court Of  
Appeals For The Seventh Circuit

**MOTION FOR LEAVE TO FILE BRIEF AMICUS  
CURIAE IN SUPPORT OF PETITIONER AND BRIEF  
AS AMICUS CURIAE IN SUPPORT OF  
PETITIONER'S WRIT FOR CERTIORARI**

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**MOTION FOR LEAVE TO FILE AMICUS CURIAE  
BRIEF IN SUPPORT OF PETITIONER**

**TO THE HONORABLE CHIEF JUSTICE AND  
THE ASSOCIATE JUSTICES OF THE  
SUPREME COURT OF THE UNITED STATES:**

Pursuant to Rule 36.1, the Multistate Tax Commission respectfully moves the Court for leave to file the accompanying amicus curiae brief in support of petitioner. The Multistate Tax Commission has requested the written consent of all parties to the case. The consent of respondent Imperial Chemical Industries PLC was requested, but refused at this stage<sup>1</sup>.

The Multistate Tax Commission (hereinafter "Commission") is an organization of states, a main purpose of which is to bring about some order to the state taxation of multistate businesses. The Commission was created under the Multistate Tax Compact and currently has nineteen full members and ten associate members.<sup>2</sup> Its

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<sup>1</sup> Counsel for respondent Imperial Chemical Industries PLC, however, did indicate that said respondent would consent to the Commission filing an amicus curiae brief, if and when the substantive merits of its case were to be reviewed by this Court.

<sup>2</sup> The current full members are the states of Alaska, Arkansas, California, Colorado, District of Columbia, Hawaii, Idaho, Kansas, Minnesota, Missouri, Michigan, Montana, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah, and Washington. The associate members are the states of Alabama, Arizona, Georgia, Louisiana, Maryland, Massachusetts, New Jersey, Ohio, Pennsylvania and Tennessee. This brief should not be read to reflect the views of any member State that files or joins the filing of a separate brief in this case.

purposes are stated in the Compact: to facilitate proper determination of state and local tax liability of multistate taxpayers; to promote uniformity and compatibility in state tax systems; to facilitate taxpayer convenience and compliance in the filing of tax returns and in tax administration; and to avoid duplicative taxation. The validity of the Multistate Tax Compact was recognized by this Court in *U.S. Steel Corp. v. Multistate Tax Commission*, 434 U.S. 452 (1978).

The issues presented in this case and their resolution by the Court are of substantial consequence to the Commission's members because those issues bear directly upon the method by which tax disputes between states and taxpayers are adjudicated. Resolution of this case will affect far more than the issue of whether California may be sued in federal district court in Illinois by a foreign parent corporation whose domestic subsidiary corporation is liable to California for a franchise tax. The Commission is gravely concerned that the decision by the Seventh Circuit, unless reversed, will cause havoc with the states' tax administration systems in that a parent corporation, which itself is not liable or subject to a state tax, will have standing to bring an action in federal court against a state where the state tax is imposed upon the corporation's subsidiary.

Under the opinion of the Seventh Circuit, such an action would not be barred by a lack of standing, nor by the Tax Injunction Act, nor by principles of comity or federalism. Suits by nontaxpayers, both foreign and domestic, could proliferate against the states if the decision of the Seventh Circuit is allowed to stand.

WHEREFORE, it is respectfully requested that leave be granted for the Multistate Tax Commission to file the accompanying amicus curiae brief addressing the issue of why this case should be heard.

Respectfully submitted,

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Dated: March 22, 1989

No. 88-1400

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In The  
**Supreme Court of the United States**  
October Term, 1988

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FRANCHISE TAX BOARD,

*Petitioner,*

v.

ALCAN ALUMINIUM LIMITED AND IMPERIAL  
CHEMICAL INDUSTRIES PLC,

*Respondents.*

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On Petition From The United States Court Of  
Appeals For The Seventh Circuit

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BRIEF AS AMICUS CURIAE IN SUPPORT OF  
PETITIONER'S WRIT FOR CERTIORARI

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## QUESTIONS PRESENTED

1. Whether a foreign company which is the sole stockholder of an American subsidiary has standing to challenge in federal court the accounting method by which the State of California determines the locally taxable income of that subsidiary; and

2. Whether, assuming that requisite standing exists in such an instance, a federal action for injunctive and declaratory relief is nevertheless barred by the Tax Injunction Act (28 U.S.C. 1341) or the principle of comity which underlies the Act.

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## STATEMENT OF INTEREST

The Multistate Tax Commission (the "Commission") is the administrative arm of the Multistate Tax Compact (the "Compact"). The Compact has been entered into by 18 member and 10 associate member states and the District of Columbia. Its purposes as stated in the Compact are to facilitate proper determination of state and local tax liability of multistate taxpayers, to promote uniformity or compatibility of tax systems, to facilitate taxpayer convenience and compliance, and to avoid duplicative taxation. The validity of the Multistate Tax Compact which established the Multistate Tax Commission was recognized by this Court in *U.S. Steel Corp. v. Multistate Tax Commission*, 434 U.S. 452 (1978).

To further the purposes of the Compact, the Commission conducts joint audits for member states. The Commission maintains audit offices in New York, Chicago and Houston, a legal office in Los Altos, California, and a headquarters office in Washington, D.C. Under the holding of the Seventh Circuit in this case, it is possible that each of the states participating in the joint audit program could be required to defend assessments proposed or made under their respective laws in the federal courts of anyone of these jurisdictions. The interest of the Multistate Tax Commission in this matter is direct and obvious. If the Seventh Circuit's decision in this case is allowed to stand, it could hamstring the Commission audits and the tax collecting efforts of each of the member states by taxpayers seeking relief in federal district courts sitting in one state regarding the legality of assessments and tax administration procedures being conducted on behalf of state tax agencies located in other states.

## SUMMARY OF ARGUMENT

The Court should grant the petition for the writ of certiorari because of the split in the federal circuits. Failure to do so and to provide clarity in this area will encourage forum shopping and increase the burden of the federal courts. Furthermore, the Court should address the question of the extent of the prohibition established by the Tax Injunction Act or, in the alternative, decide whether the principle of comity extends to the circumstances presented here. Finally, the Court should resolve whether a shareholder injury arises as the result of the application of a tax to the corporation in which the stock is owned.

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## ARGUMENT

### I.

#### THERE IS AN URGENT NEED TO RESOLVE THE CONFLICT BETWEEN THE SEVENTH CIRCUIT'S DECISION IN THIS CASE AND DECISIONS OF THE SECOND AND NINTH CIRCUIT COURTS OF APPEAL.

The Ninth Circuit has twice decided that a foreign company shareholder has no standing to contest the state tax liability of its American subsidiary. *Shell Petroleum, N.V. v. Graves* (9th Cir. 1983) 709 F.2d 593, cert. den. 464 U.S. 1012 (1983), and *EMI, Ltd. v. Bennett* (9th Cir. 1984) 738 F.2d 994, cert. den. 469 U.S. 1073 (1984). The Second Circuit reached the same conclusion. *Alcan Aluminium Ltd. v. FTB*, 558 F.Supp. 624 (S.D.N.Y. 1983), affd. mem. 742 F.2d 1430 (2nd Cir., 1983), cert. den. 464 U.S. 1041

(1984). The Seventh Circuit in the instant cases has determined that the foreign shareholder does have standing. Amicus curiae respectfully urges the Court to reconcile the differences between the Circuits.

The circumstances involved in these cases demonstrate the need for reconciliation. The lack of a uniform rule on standing will continually give rise to the type of judicial forum shopping plainly evident in this case; and that lack of uniformity will further burden the already strained resources of the federal judiciary. California, the state asserting the tax, is in the Ninth Circuit. New York, where the Franchise Tax Board has an audit office and where Alcan unsuccessfully brought its first federal suit, is in the Second Circuit. Chicago, where the Franchise Tax Board also has an office and where this action was brought, is in the Seventh Circuit. The Franchise Tax Board also has an audit office in Houston. If Alcan had been unsuccessful in the Seventh Circuit, there is little doubt that an action in the Fifth Circuit would have been brought.<sup>1</sup>

The mischief which can result from this divergence among the Circuits and the opportunities for forum shopping are obvious. It is not a risk peculiar to California.

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<sup>1</sup> Alcan was audited by both the New York and Chicago offices of the California Franchise Tax Board but has not been audited by the Board's Houston office. *Alcan Aluminium Ltd v. FTB*, 558 F. Supp. 624 and Stipulation of Facts as Revised ¶ 16, Docket #84-C-6932 (Judge Williams) N-D Ill. There is no reason to believe this fact would forestall a Fifth Circuit action. ICI was never audited by the Board's Chicago office but nevertheless brought this action in the Seventh Circuit. Joint Stipulation of Facts Sec. 9 Docket #84-C-8906 (Judge Williams) N.D. Ill.

Every state is subject to this risk.<sup>2</sup> The Seventh Circuit has in effect conceded that its decision in this case is in conflict with decisions of the Second and Ninth Circuits. The concession is unnecessary as the conflict is obvious. Amicus urges the Court to resolve this conflict.

## II.

### THE DECISION BELOW IS INCONSISTENT WITH THE OBJECTIVES OF THE TAX INJUNCTION ACT AND THE PRINCIPLES OF COMITY ON WHICH THE ACT IS BASED.

The Tax Injunction Act, 28 U.S.C. 1341, provides that:

"The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."

There appears to be no question that the corporations in which respondents are shareholders have a plain, speedy and efficient remedy in the California courts. They have this remedy because they are the California taxpayers. It also appears to be uncontroverted that the taxpayers would be barred from bringing these federal actions by the Tax Injunction Act. Nonetheless, it is alleged that there is no remedy in the state courts. This allegation is apparently based on the fact that respondents are not California taxpayers and therefore they have no standing in California's courts. On this basis the

<sup>2</sup> A survey by the State of Minnesota in 1986 found that 18 states maintain out-of-state audit offices (15 in Chicago). Subsequent to that study both Minnesota and New Jersey are known to have added out-of-state audit offices.

Seventh Circuit finds that these lawsuits are not barred by the Tax Injunction Act.

The Tax Injunction Act requires that there be "a plain, speedy and efficient remedy . . . in the courts of such state." In this case, it is clear that the corporate taxpayers have such a remedy. The case thus presents the question of whether the existence of a state remedy in the appropriate party's hands bars a federal action by someone else.

The Tax Injunction Act was enacted in 1937 because of concerns that taxpayers were seeking increased involvement by federal courts, based upon diversity of citizenship, in state tax matters.<sup>3</sup> In introducing the bill that ultimately became the Tax Injunction Act, Senator Bone explained:

"The existing practice of the Federal courts to entertain tax-injunction suits make[s] it possible for foreign corporations [exercising the diversity jurisdiction] to withhold from a State and its governmental subdivisions taxes in such vast amounts and for such long periods as to disrupt State and county finances, and thus make it possible for such corporations to determine for themselves the amount of taxes they will pay. 81 CongRec. 1416 (1937)."

The Senate Report on the bill states, in part:

"It is the common practice for statutes of the various States to forbid actions in State courts to enjoin the collection of State and county taxes unless the tax

<sup>3</sup> A thorough discussion of the background of the Tax Injunction Act was presented by Justice Brennan (joined in by Justice Marshall, Justice Stevens and Justice O'Connor) in a concurring opinion in *Fair Assessment in Real Estate v. McNary*, 454 U.S. 100 at 125-133 (1981).

law is invalid or the property is exempt from taxation, and these statutes generally provide that taxpayers may contest their taxes only in refund actions after payment under protest. This type of State legislation makes it possible for the States and their various agencies to survive while long-drawn-out tax litigation is in progress. If those to whom the Federal courts are open may secure injunctive relief against the collection of taxes, the highly unfair picture is presented of the citizen of the State being required to pay first and then litigate, while those privileged to sue in the Federal courts need only pay what they choose and withhold the balance during the period of litigation.

"The existing practice of the Federal courts in entertaining tax-injunction suits against State officers makes it possible for foreign corporations doing business in such States to withhold from them and their governmental subdivisions, taxes in such vast amounts and for such long periods of time as to seriously disrupt State and county finances. The pressing needs of these States for this tax money is so great that in many instances they have been compelled to compromise these suits, as a result of which substantial portions of the tax have been lost to the States without a judicial examination into the real merits of the controversy." S Rep No. 1035, at 1-2 (1937).

The above quoted material clearly establishes a legislative concern that foreign out-of-state corporations were pleading diversity to obtain access to federal courts and to avoid state courts. This case raises the question of whether the use of the "instrumentality" of a subsidiary should allow for avoidance of the provisions of the Tax Injunction Act. There appears to be no reason why the creation of a subsidiary should be any more effective than

the pleading of diversity. The harm to the states is identical, only the strategy is different.

As support for its position the Seventh Circuit cites its earlier decision in *Alcan Aluminium Ltd. v. Department of Revenue (Alcan-Oregon)*, 724 F.2d 1294 (7th Cir. 1983), which in turn cited *Capitol Industries-EMI, Inc. v. Bennett*, 681 F.2d 1107 (9th Cir. 1982). In the *Capitol Industries* case the Ninth Circuit ultimately resolved the standing issue in favor of California (see *EMI Ltd. v. Bennett, supra*) rendering its construction of the Tax Injunction Act irrelevant. No appeal was taken in *Alcan-Oregon* so this Court has had no occasion to review this question. It is now presented with that opportunity. Amicus urges it to do so.

If the Tax Injunction Act does not specifically bar this action, then consideration should be given to whether the principles of comity require the federal judiciary to abstain. As this Court has noted:

[The Tax Injunction Act] "... 'has its roots in equity practice, in principles of federalism, and in recognition of the imperative need of a State to administer its own fiscal operations.' *Tully v. Griffin, Inc.*, 429 U.S. (68), at 73. This last consideration was the principal motivating force behind the Act; this legislation was first and foremost a vehicle to limit drastically federal district court jurisdiction to interfere with so important a local concern as the collection of taxes." *Rosewell v. LaSalle National Bank*, 450 U.S. 503, 522 (1981).

In *Fair Assessment in Real Estate v. McNary*, 454 U.S. 100 (1981), this Court had occasion to consider the implications of the Tax Injunction Act and comity in conjunction with a suit for damages brought under 42 U.S.C.

1983 based upon the alleged invalidity of a state tax statute. Although an action for damages is not barred directly by the Act, the Court held such an action is barred under principles of comity. As Justice Rehnquist stated:

"The post-Act vitality of the comity principle is perhaps best demonstrated by our decision in *Great Lakes Dredge & Dock Co. v. Huffman*, 319 US 293, 87 L Ed 1407, 63 S Ct 1070 (1943). Several Louisiana taxpayers brought an action in Federal District Court seeking a declaratory judgment that the state tax law as applied to them was unconstitutional and void. Although [Section] 1341 was raised as a possible bar to the suit, as it has been raised in this case, 'we [found] it unnecessary to inquire whether the words of the statute may be so construed as to prohibit a declaration by federal courts concerning the invalidity of a state tax.' 319 US, at 299. Instead, 'we [were] of the opinion that those considerations which have led federal courts of equity to refuse to enjoin the collection of state taxes, save in exceptional cases, require[d] a like restraint in the use of the declaratory judgment procedure.'

• • •

"The Court's reliance in *Great Lakes* upon the necessity of federal-court respect for state taxing schemes demonstrates not only the post-Act vitality of the comity principle, but also its applicability to actions seeking a remedy other than injunctive relief. The focus was not on the specific form of relief requested, but on the fact that in every practical sense [it] operate[d] to suspend collection of the state taxes until the litigation [was] ended." 454 U.S. at 110 and 111.

In the instant case the issue is not the remedy sought but the party seeking it. However, the considerations are the same. The petitioner in *Fair Assessment* argued:

"... that damages actions are inherently less disruptive of state tax systems than injunctions or declaratory judgments, and therefore should not be barred by prior decisions of this court." *Supra* at 113.

Justice Rehnquist responded:

"We disagree. Petitioners will not recover damages under [Section] 1983 unless a district court first determines that respondents' administration of the County tax system violated petitioners' constitutional rights. In effect, the district court must first enter a declaratory judgment like that barred in *Great Lakes*. We are convinced that such a determination would be fully as intrusive as the equitable actions that are barred by principles of comity. Moreover, the intrusiveness of such ?1983 actions would be exacerbated by the nonexhaustion doctrine of *Monroe v. Pape*, 365 US 167 (1961). Taxpayers such as petitioners would be able to invoke federal judgments without first permitting the State to rectify any alleged impropriety."

The same result would be reached in this case though the operative question is the party not the relief sought. This Court is urged to decide whether or not comity dictates abstention.

### III.

#### SEVENTH CIRCUIT'S DECISION CREATES AN IRRATIONAL EXCEPTION TO THE STOCKHOLDER STANDING RULE

It is settled that a stockholder is not personally injured by a wrong done to the corporation in which he

holds an interest; his rights are derivative. *Pittsburgh & W. V. R. v. U.S.*, 281 U.S. 479, 487 (1930). Thus, if the cause of action is the corporation's, the corporation is a necessary party, and relief must be sought either directly by the corporation or through a derivative action brought on its behalf. Cf., *Ross v. Bernhard*, 396 U.S. 531 (1970); *Koster v. Lumbermans Mutual Co.* 330 U.S. 518, 522-523 (1947); *Meyer v. Fleming*, 327 U.S. 161, 167 (1946). The rule cannot be avoided by an allegation of injuries to the stockholder which are the indirect result of wrongs against the corporation. See, *Pittsburgh & W. V. R.*, *supra*, at 486-487. An exception to the rule exists, however, when the shareholder has a direct, personal interest in a cause of action. *Buschmann v. Professional Men's Ass'n.*, 405 F.2d 659 (7th Cir. 1969); *Schaffer v. Universal Rundle Corp.*, 397 F.2d 893 (5th Cir. 1968)

The Seventh Circuit has found such an exception in this case on the theory that the California tax at issue burdens foreign companies' decisions to conduct business through subsidiaries. It has concluded that this "burden" on the foreign companies' decision-making process gives rise to a direct and personal injury sufficient to confer standing.<sup>4</sup>

The logical consequence of the decision below is that in every situation in which a shareholder wishes to bring a cause of action based upon an alleged wrong to the corporation, it can claim to have a direct and personal injury by reason of the fact that the same wrong affects its

<sup>4</sup> The "reach" which the Seventh Circuit has made is demonstrated by the fact that respondents themselves never argued this injury.

"decision" to conduct a particular activity through the corporation. This is true regardless of whether foreign, interstate or intrastate commerce is involved. The logic of the Seventh Circuit's decision may also extend to permitting domestic parent corporations to have standing in federal district courts in one state to challenge the imposition of state taxes imposed upon their subsidiaries in other states. Amicus curiae submits that this Court should consider whether the "decision" to operate through a subsidiary establishes a direct and personal right sufficient for standing purposes.

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## CONCLUSION

The Seventh Circuit's decision breaks new ground in areas which directly affect the administration and collection of state taxes. First, it is inconsistent with prior decisions of the Second and Ninth Circuits which this Court has allowed to stand. Second, it construes the Tax Injunction Act in a manner which may open the federal court system to state tax litigation in circumstances that are inconsistent with the principles of federalism, as well as sound public policy considerations. Third, it refuses to apply the principles of comity to preclude a nontaxpayer from seeking federal injunctive and declaratory relief against state tax authorities. Fourth and finally, it may create a course of action for a shareholder any time an injury is alleged to a corporation because of its potential to affect the shareholder's "decision" to participate in an activity through a corporation. Amicus curiae urges the court to grant certiorari and review all of these questions

so that it can establish clear rules for taxpayers, the states  
and the federal courts.

Respectfully submitted,

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Supreme Court, U.S.

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In The  
**Supreme Court of the United States**  
October Term, 1988

—o—  
FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA; LEONARD WILSON, Individually and as District Manager, Chicago Office of the Franchise Tax Board of the State of California; and B.M. RARANG, Individually and as Auditor, Chicago Office of the Franchise Tax Board of the State of California,

*Petitioners,*

v.

ALCAN ALUMINIUM LIMITED AND IMPERIAL  
CHEMICAL INDUSTRIES PLC,

*Respondents.*

—o—  
**ON PETITION FOR A WRIT OF CERTIORARI TO  
THE UNITED STATES COURT OF APPEALS  
FOR THE SEVENTH CIRCUIT**  
—o—

**BRIEF OF AMICI CURIAE IN SUPPORT OF THE  
PETITIONERS BY THE STATE OF NEW JERSEY  
AND SEVERAL OTHER STATES**  
—o—

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BRIEF OF THE STATES OF  
 NEW JERSEY, ARKANSAS, COLORADO  
 CONNECTICUT, FLORIDA, HAWAII, IDAHO,  
 ILLINOIS, INDIANA, IOWA, KANSAS, MARYLAND,  
 MINNESOTA, MISSOURI, MONTANA, NEBRASKA,  
 NEW HAMPSHIRE, NEW MEXICO, NORTH  
 DAKOTA, OHIO, OREGON, PENNSYLVANIA,  
 RHODE ISLAND, SOUTH DAKOTA, TENNESSEE,  
 TEXAS, UTAH, VERMONT, VIRGINIA, WASH-  
 INGTON, WISCONSIN and WYOMING  
 AS AMICI CURIAE

## INTEREST OF AMICI CURIAE

This brief in support of California's petition for a writ of certiorari is submitted on behalf of the States of New Jersey, Arkansas, Colorado, Connecticut, Florida, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Maryland, Minnesota, Missouri, Montana, Nebraska, New Hampshire, New Mexico, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington, Wisconsin and Wyoming pursuant to *SUP.Ct.R.* 36.4

Many of these states have tax systems that are substantively different from California's provisions at issue here. However, the amici share California's concern with two fundamental questions before this Court, namely, who may challenge the validity of state taxes, and where may such challenges be waged? Prior to issuance of the Seventh Circuit's opinion, amici had presumed that the answers to these questions were obvious: the proper party to challenge the validity of a state tax is the party against

whom the tax is assessed, and relief should be sought by that party in the courts of the state levying the tax. The Court of Appeals for the Seventh Circuit, however, has taken just the opposite approach, ruling that state taxes levied against a corporate taxpayer may be challenged by a parent company-stockholder in the federal courts. The lower court concluded that such an action is not barred by principles of standing or comity, the Tax Injunction Act, 28 U.S.C. § 1341, or by the fact that the taxes in question have been imposed only upon the corporate taxpayer, which alone is legally liable for their payment.

The decision below permits unwarranted federal intrusion in state tax matters, thus threatening the integrity and effectiveness of state tax administration. The amici states therefore urge that certiorari be granted.

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### SUMMARY OF ARGUMENT

This case presents more than a narrow, technical standing issue. It raises important questions of law, comity and federalism.

Until the Seventh Circuit's decision in this case, the federal courts had adhered to the general rule that a stockholder cannot complain of wrongs inflicted on the corporation and had held that a foreign corporate stockholder lacked standing to challenge the constitutionality of state taxes assessed against its domestic subsidiary. The Seventh Circuit's opinion directly conflicts with these precedents. Moreover, the Seventh Circuit's opinion conflicts with the policies of federalism and comity inherent in the

Tax Injunction Act. The opinion permits a corporate stockholder to sue in federal court to challenge a state tax, which is precisely what the Tax Injunction Act is intended to prevent. This result is flatly inconsistent with the Court's cases, which have strictly construed the Tax Injunction Act to prevent federal court jurisdiction in state tax cases.

If allowed to stand, the Seventh Circuit's decision will have serious ramifications. First, the decision will lead to forum shopping and encourage maneuvering from one federal court to another to obtain standing, a process bound to result in an unequal administration of the laws. This case itself arose as a result of forum shopping, for the respondent foreign parent corporations could not have pursued these actions successfully in the Ninth Circuit, the circuit which encompasses the state which has imposed the taxes. Nor could the respondent foreign parent corporations have pursued these actions successfully in the Second Circuit, where a specific decision involving respondent Alcan already had been handed down against Alcan. Second, the ability of the states to administer their taxes without the threat of federal injunctions will be seriously eroded for federal jurisdiction will be available to a corporate stockholder claiming injury on account of state taxes imposed on its subsidiary. Third, actions of this type are likely to proliferate in federal court because the Seventh Circuit's reasoning would apply as well to a domestic corporate stockholder asserting that it owns its domestic subsidiary as an "instrumentality" of interstate commerce such that the normal rules of standing do not apply to bar suit by a stockholder for injuries suffered by the corporation.

## ARGUMENT

### POINT I

#### **CERTIORARI SHOULD BE GRANTED BECAUSE THE SEVENTH CIRCUIT'S OPINION CREATES A CLEAR CONFLICT AMONG THE CIRCUITS.**

It is the general rule that a stockholder cannot complain of injuries that are the indirect result of wrongs against the corporation. *Pittsburg & W. V. Ry. Co. v. United States*, 281 U.S. 479, 486-87 (1930). The rationale for this rule is that a stockholder is not personally injured by a wrong done to the corporation because his rights are derivative. *Id.* at 487-88.

On three previous occasions, circuit courts have adhered to this general rule and denied standing to a foreign parent corporation seeking to contest the constitutionality of state taxes assessed against its domestic subsidiary. Standing was denied in two decisions rendered by the Ninth Circuit: *Shell Petroleum, N.V. v. Graves*, 709 F.2d 593, 595-96 (9th Cir. 1983), *cert. den.* 464 U.S. 1012 (1983), and *EMI Ltd. v. Bennett*, 738 F.2d 994, 996-99 (9th Cir. 1984), *cert. den.* 469 U.S. 1073 (1984). Similarly, a New York district court held, and the Second Circuit affirmed, that a foreign parent corporation lacked standing to sue a state to challenge the state tax treatment of a domestic subsidiary. *Alcan Aluminum Ltd. v. Franchise Tax Bd. of Cal.*, 558 F. Supp. 624, 628-29 (S.D.N.Y. 1983), *aff'd mem.* 742 F.2d 1430 (2d Cir. 1983), *cert. den.* 464 U.S. 1041 (1984).

The Court of Appeals for the Seventh Circuit has conceded in its opinion that its holding on the standing issue creates an "arguable conflict" with the two decisions of

the Ninth Circuit. *See* Pet. App. at A1; *see also* Pet. App. at A17 n.12. Amici submit that not only does the decision below create a clear conflict with the Ninth Circuit but also a clear conflict with the Second Circuit. This conflict is not merely a conflict in dicta or in the general principles utilized in these cases. It is a direct, real and intolerable conflict over how the rules of standing are to be applied by different circuits given identical facts.

Until such time as this clear conflict between the circuits is resolved, the basic question of standing to litigate the constitutionality of a state's taxing system will depend solely upon which circuits have venue. Many states in addition to California have tax offices outside their boundaries,\* and several have such offices in Chicago within the venue of the Seventh Circuit. Thus, until such time as the present conflict among the circuits is resolved, those desiring to question the validity of a particular state tax obviously will be tempted by the "virtues" of forum shopping. This is the inescapable consequence of having the Seventh Circuit recognize standing on the part of a corporate stockholder while the Second and Ninth Circuits do not. Amici states respectfully urge this Court to resolve the conflict before the Seventh Circuit's decision spurs further litigation.

---

\*A survey undertaken by the State of Minnesota in 1986 listed the following states, in addition to California, as having out-of-state audit offices: Alaska, Colorado, Florida, Illinois, Indiana, Iowa, Louisiana, Maryland, Massachusetts, Michigan, Missouri, New York, Nevada, Oregon, South Carolina, Tennessee, Washington and Wisconsin. Subsequently, Minnesota, New Jersey and Ohio have established out-of-state audit offices.

## POINT II

### **CERTIORARI SHOULD BE GRANTED TO REVIEW THE IMPORTANT ISSUE OF WHETHER THE TAX INJUNCTION ACT APPLIES TO FEDERAL SUITS BROUGHT BY THE SOLE OR CONTROLLING STOCKHOLDER OF A CORPORATE TAXPAYER.**

The Tax Injunction Act prohibits district courts from enjoining, suspending or restraining state taxes "where a plain, speedy and efficient remedy may be had in the courts of such State." 28 U.S.C. § 1341. The Seventh Circuit held in the instant case that the Act does not bar a foreign parent corporation from bringing an action to enjoin the collection of a state tax imposed on its subsidiary. The court reasoned that comity and federalism cannot justify withholding federal jurisdiction from a party with no cause of action in state court to redress its own direct and independent injury.

The opinion of the Seventh Circuit is out of step with many opinions of this Court which have recognized "the dangers inherent in disrupting the administration of state tax systems." *California v. Grace Brethren Church*, 457 U.S. 393, 410 n.23 (1982). As Justice Brennan has explained:

The special reasons justifying the policy of federal noninterference with state tax collection are obvious. The procedures for mass assessment and collection of state taxes and for administration and adjudication of taxpayers' disputes with tax officials are generally complex and necessarily designed to operate according to established rules. State tax agencies are organized to discharge their responsibilities in accordance with the state procedures. If federal declaratory re-

lief were available to test state tax assessments, state tax administration might be thrown into disarray, and taxpayers might escape the ordinary procedural requirements imposed by state law. During the pendency of the federal suit the collection of revenue under the challenged law might be obstructed, with consequent damage to the State's budget, and perhaps a shift to the State of the risk of taxpayer insolvency. [*Perez v. Ledesma*, 401 U.S. 82, 128 n.17 (1971) (concurring and dissenting in part)].

See also *Fair Assessment in Real Estate Ass'n v. McNary*, 454 U.S. 100, 108 n.6 (1981).

The Seventh Circuit has ignored the dangers alluded to in *Grace Brethren Church* and has interpreted the Act without regard to its principal purpose: "to limit drastically federal district court jurisdiction to interfere with so important a local concern as the collection of taxes." *Rosewell v. LaSalle National Bank*, 450 U.S. 503, 522 (1981). The opinion of the Seventh Circuit also runs contrary to what this Court has characterized as the "historical reluctance of the federal courts to interfere with the operation of state tax systems if the taxpayer had available an adequate remedy in the state courts." *California v. Grace Brethren Church*, *supra*, at 412. The opinion of the Seventh Circuit looks only to the technical language of the Act and concludes that it does not apply to a non-taxpayer because a non-taxpayer has no state remedy. It thus gives preference to a party who is not even part of the taxing process. And it does so despite the fact that the party complaining of the state treatment has full control over the pursuit of the state remedies by the actual taxpayer.

This Court has stated that in order to be "faithful to the congressional intent 'to limit drastically' federal-

court interference with state tax systems, [the courts] must construe narrowly the 'plain, speedy and efficient' exception to the Tax Injunction Act." *California v. Grace Brethren Church*, *supra*, at 413. The Seventh Circuit in its opinion has departed from this rule of narrowly construing the exception and in doing so has encouraged interference by the federal courts in state tax matters. As the Court stated in *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293, 298 (1943) (quoting *Matthews v. Rodgers*, 284 U.S. 521, 525 (1932)):

'The scrupulous regard for the rightful independence of state governments which should at all times actuate the federal courts, and a proper reluctance to interfere by injunction with their fiscal operations, require that such relief should be denied in every case where the asserted federal right may be preserved without it.'

...

Interference with state internal economy and administration is inseparable from assaults in the federal courts on the validity of state taxation, and necessarily attends injunctions, interlocutory or final, restraining collection of state taxes. These are the considerations of moment which have persuaded federal courts of equity to deny relief to the taxpayer. . . .

In sum, the decision of the court below is incorrect because it fails to recognize that federalism and comity are the underpinnings of the Tax Injunction Act and that under decisions of this Court, the Act should be interpreted to further those principles. The net effect of the lower court's decision will inevitably be to expand the jurisdiction of federal courts at the expense of comity, federalism and states' rights.

### POINT III

#### **CERTIORARI SHOULD BE GRANTED BECAUSE THE SEVENTH CIRCUIT'S OPINION IMPROPERLY PERMITS FEDERAL INTRUSION IN STATE TAX MATTERS AT THE INSTIGATION OF A CORPORATE STOCKHOLDER.**

The Seventh Circuit has concluded that the normal shareholder standing rules do not apply to a parent company seeking to challenge state taxes levied against a subsidiary company because the parent owns its subsidiary as an "instrumentality" of commerce. While the actual matter before the court involved a foreign parent in control of an American subsidiary, the court's reasoning apparently would apply to an American parent in control of a subsidiary as an "instrumentality" of interstate commerce. As a result, the doors of the federal courts have been thrown wide open to any corporation that is disenchanted with the state tax treatment of a subsidiary.

The Seventh Circuit erroneously has fashioned a new and extremely broad type of "injury" to confer standing in this case. Here the lower court found the parent corporations' independent injury in the "potential" of California's taxing method "to disfavor a particular mode of foreign participation in the American economy," which potential in this case "burden[ed] foreign companies' decisions to conduct business through subsidiaries operating in California. . . ." Pet. App. at A15-A16. It is difficult to see how any state tax provision which potentially disfavors "a particular mode of foreign participation in the American economy," such as a sales tax provision which favors the subsidiary's leasing of property over its out-

right purchase or sale of property, would not have the potential of requiring foreign corporations to make the same type of decisions that the Seventh Circuit defines as an independent injury sufficient to confer standing.

The end result of the Seventh Circuit's new standing rule appears to be that if the state tax statute gives any opportunity for tax planning by the foreign (or domestic) controlling parent, that opportunity is to be viewed as a burden that provides standing to the parent in the federal courts to challenge the taxes levied upon a subsidiary. But this sort of opportunity/burden arises solely from the potential for control which every majority stockholder exercises over every corporation it owns. Thus, California is correct in characterizing the Seventh Circuit's holding as a broad and erroneous departure from the established rule that denies standing to stockholders.

---

### CONCLUSION

The issues addressed by the Seventh Circuit in its opinion do not affect only petitioner California but have ramifications far beyond the parties and facts in that opinion. For all of the reasons stated herein, amici curiae respectfully urge this Court to grant the petition for a writ of certiorari.

Respectfully submitted,

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JUN 8 1989

JOSEPH F. SPANIOLO, JR.  
CLERK

In The  
**Supreme Court of the United States**  
October Term, 1988

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, et al.

*Petitioners,*

vs.

ALCAN ALUMINIUM LIMITED AND  
IMPERIAL CHEMICAL INDUSTRIES PLC,

*Respondents.*

On Writ Of Certiorari To  
The United States Court Of Appeals  
For The Seventh Circuit

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140JP

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CHRONOLOGICAL LIST OF  
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*Alcan Aluminium Limited* – District Court Docket 84-C-6932

August 10, 1984	Plaintiff's complaint filed in U.S. District Court for Northern District of Illinois, Eastern Division.
September 7, 1984	Defendants' motion to dismiss filed.
January 11, 1985	Memorandum Opinion and Order entered denying motion to dismiss.
February 1, 1985	Answer to complaint filed.
June 14, 1985	Order entered reassigning case to Judge Williams.
February 3, 1986	Stipulation of Facts, as Revised, filed; plaintiff's motion for summary judgment filed.
February 6, 1986	Order entered granting motions for leave to file briefs <i>amici curiae</i> on behalf of the Governments of Canada, the United Kingdom, Australia, Switzerland, Japan and the member states of the European Communities (Belgium, Denmark, France, Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain and the United Kingdom).
February 14, 1986	Order entered granting motion of United States of America leave to file a brief <i>amicus curiae</i> .
March 6, 1986	Brief <i>amicus curiae</i> of the United States filed.

March 28, 1986	Defendants' cross-motion for summary judgment filed.
May 5, 1986	Plaintiff's reply to defendants' cross-motion for summary judgment filed.
July 30, 1987	Judgment of District Court entered, dismissing action pursuant to Memorandum Opinion and Order dated July 29, 1987 (text printed in Appendix B to Petition for Writ of Certiorari at A-21).
August 6, 1987	Plaintiff's notice of appeal filed.
<i>Imperial Chemical Industries PLC - District Court Docket 84-C-8906</i>	
October 15, 1984	Plaintiff's complaint filed in U.S. District Court for Northern District of Illinois, Eastern Division.
January 18, 1985	Defendants' motion to dismiss filed.
January 28, 1985	Plaintiff's motion for relatedness to Action No. 84C 6932 filed.
January 29, 1985	Defendants' letter withdrawing motion to dismiss filed.
January 31, 1985	Orders entered granting motion for relatedness and reassigning case.
February 15, 1985	Defendants' answer to complaint filed.
June 14, 1985	Order entered reassigning case to Judge Williams.
December 2, 1985	Joint stipulation of facts filed.

January 31, 1986	Supplemental joint stipulation of facts filed; plaintiff's summary statement of stipulated facts filed; plaintiff's motion for summary judgment filed.
February 6, 1986	Order entered granting motions for leave to file briefs <i>amici curiae</i> on behalf of the Governments of Canada, the United Kingdom, Australia, Switzerland, Japan and the Member States of the European Communities (Belgium, Denmark, France, Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain and the United Kingdom).
February 14, 1986	Order entered granting motion of United States of America leave to file a brief as <i>amicus curiae</i> .
February 24, 1986	Second supplemental stipulation of facts filed.
March 6, 1986	Brief <i>amicus curiae</i> of the United States filed.
March 28, 1986	Defendants' opposition to plaintiff's motion for summary judgment filed; defendants' cross-motion for summary judgment filed.
April 29, 1986	Plaintiff's reply to defendants' cross-motion for summary judgment filed.

July 30, 1987 Judgment of District entered, dismissing action pursuant to memorandum opinion and order dated July 29, 1987 (text printed in Appendix B to Petition for Writ of Certiorari at A-21).

August 6, 1987 Plaintiff's notice of appeal filed.

*Court of Appeals – Docket No. 87-2239 (Alcan); Docket No. 87-2295 (Imperial)*

August 28, 1987 Order entered granting motions for leave to file briefs *amici curiae* on behalf of the Governments of Canada, the United Kingdom, Australia, Japan, and Switzerland, and the Member States of the European Communities (Belgium, Denmark, France, Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom).

September 2, 1987 Order entered consolidating appeals for purposes of briefing and disposition.

September 9, 1987 Motion for reconsideration of order consolidating cases on appeal filed.

September 11, 1987 Order entered granting in part and denying in part motion for reconsideration of order consolidating cases on appeal.

September 24, 1987 Order entered granting motion of United States of America for extension of time in which to file brief *amicus curiae* (corrected on October 5, 1987).

October 19, 1988 Opinion and judgment of the Court of Appeals filed (text printed in Appendix A to Petition for a Writ of Certiorari at A-1).

November 2, 1988 Defendants' petition for rehearing, with suggestion for rehearing en banc, filed.

November 29, 1988 Answer of Imperial to petition for rehearing filed.

November 30, 1988 Reply of Alcan to petition for rehearing filed.

January 9, 1989 Order entered denying petition for rehearing.

January 13, 1989 Defendants' motion for stay of mandate filed.

January 17, 1989 Plaintiffs' opposition to motion for stay of mandate filed.

January 24, 1989 Order entered granting stay of mandate.

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IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF ILLINOIS  
EASTERN DIVISION

ALCAN ALUMINIUM LIMITED, )  
Plaintiff, )  
vs. )  
Civ. 84 C 6932  
THE FRANCHISE TAX BOARD )  
OF THE STATE OF CALIFORNIA, )  
operating through its Chicago ) COMPLAINT  
office; Leonard Wilson, individu- )  
ally and as District Manager, Chi- )  
cago Office of the Franchise Tax )  
Board of the State of California; )  
and B. M. Rarang, individually )  
and as Auditor, Chicago Office of )  
The Franchise Tax Board of the )  
State of California, )  
Defendants, )

Plaintiff Alcan Aluminium Limited ("Alcan"), by its attorneys Lawrence A. Salibra, II, Peter D. Miller and Sidley & Austin, for its complaint alleges as follows:

## I

1. Alcan is a corporation organized and existing under the laws of the Commonwealth of Canada. Its headquarters and principal place of business are in Montreal, Quebec.

2. At all times relevant herein, Plaintiff and its subsidiaries engaged in all phases of the aluminum business on an international scale. Alcan is independent of, and operates in competition with, all other major world aluminum producers. Its operations include the mining and

processing of bauxite, an aluminum-bearing ore, the conversion of bauxite into alumina, the generation of electric power for use in smelting aluminum, the smelting of aluminum alloys into semi-finished and finished products, the production and sale of chemicals, transportation services for cartage of raw materials, metal and general cargo, and engineering services.

3. During the relevant time period, Plaintiff's subsidiaries and related companies had bauxite holdings and smelted primary aluminum in seven different countries, produced alumina in six countries, fabricated aluminum in twenty-nine countries, operated sales outlets in over one hundred different countries and maintained warehouse inventories in various international markets. At all times relevant herein, nearly one hundred subsidiaries of Plaintiff operated wholly outside the United States.

4. At all times relevant herein, Plaintiff did not have a permanent place of business in the United States, nor did any of its non United States subsidiaries.

## II.

5. Alcan Aluminum Corporation ("Alcancorp") is a corporation organized and existing under the laws of the State of New York. Its principal place of business is in Cleveland, Ohio. Plaintiff indirectly owns all of the issued and outstanding stock of Alcancorp.

6. Alcancorp and its subsidiaries, at all times relevant, engaged in the business of fabricating and selling in the United States aluminum products consisting of aluminum sheet and coil, plate, metal powders and pigments,

electrical power cable, building products, primary ingot and other metal and allied industrial products.

7. AlcanCorp conducts certain of its business operations in the State of California and is duly qualified to do business within the State of California.

### III.

8. The Franchise Tax Board of the State of California ("FTB") is an agency of the State of California. It maintains a permanent office for the transaction of its official business within the Eastern Division of the Northern District of Illinois.

9. Defendant Leonard Wilson is District Manager of the Chicago Office of the FTB and maintains his regular place of business within the Eastern Division of the Northern District of Illinois. He is sued herein both individually and in his capacity as District Manager of the Chicago Office of the FTB.

10. Defendant B. M. Rarang is an auditor in the Chicago Office of the FTB and maintains his regular place of business within the Eastern Division of the Northern District of Illinois. He is sued herein both individually and in his capacity as an auditor in the Chicago Office of the FTB.

11. Defendants have the power and duty to administer the Bank and Corporation Tax Law of the State of California, California Government Code Secs. 15700 and 15701, and California Revenue and Taxation Code Sec. 26422, as well as other provisions of the laws of the State of California respecting taxation ("California Tax Law").

Defendants administer the California Tax Law with respect to numerous corporations through their Chicago Office.

### PLAINTIFF'S FIRST CLAIM FOR RELIEF

12. The Chicago Office of the FTB is auditing and determining the proper level of taxation on Plaintiff's subsidiary, AlcanCorp. Defendants Raring and Wilson currently have management and supervisory responsibility for that file.

13. Defendant, FTB, has since 1965 computed and assessed taxes not solely upon California's apportioned share of income (all of which is derived from the United States), but on an apportioned share of the total income of AlcanCorp, Plaintiff and Plaintiff's wholly foreign subsidiaries. That method of taxation is referred to herein as worldwide unitary income taxation.

14. Plaintiff, as a result of such taxation, has been required to produce information regarding its non United States activities and this has resulted in an administrative and financial burden.

15. Defendants have and unless restrained by this Court will continue to impose such worldwide unitary income taxation upon Plaintiff and its non United States subsidiaries.

16. Neither Plaintiff nor any of its non United States subsidiaries, however, is subject to the taxing jurisdiction of the State of California. Neither Plaintiff nor any of its non United States subsidiaries carries on business in the United States and therefore is not subject to United States

income taxes. Indeed, each non United States subsidiary of Plaintiff paid or will pay tax due on its net income to its host country during the relevant time period. The imposition by Defendants of such worldwide unitary income taxation constitutes impermissible double taxation, and, therefore, violates the Foreign Commerce Clause of the United States Constitution.

17. Moreover, using worldwide unitary income as a base for taxation, imposes a tax upon Plaintiff and its non United States subsidiaries. The actions of the Defendants, in imposing such worldwide unitary income taxation, has been and would be taken under color of the purported authority of the California Tax Law, and therefore is in violation of the Foreign Commerce Clause of the Constitution.

18. Plaintiff will be irreparably injured by the actions of Defendants described above, unless Defendants are enjoined and restrained by this Court. Plaintiff does not have an adequate remedy at law.

19. This action arises under the Supremacy and Foreign Commerce Clauses of the Constitution of the United States. This Court accordingly has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. Secs. 1331, 1337, 1343 and 2201. The amount in controversy herein exceeds \$10,000, exclusive of interest and costs.

20. All Defendants maintain an office and reside within this District. The actions of Defendants which are the subject of this suit, as more fully set out above, would be taken in this District under the purported authority of the California statutes previously cited. Venue is properly laid in this District pursuant to 28 U.S.C. Sec. 1391(b).

## PLAINTIFF'S SECOND CLAIM FOR RELIEF

21. Plaintiff repeats the allegations of paragraphs 1 through 20 hereof as if fully set forth herein.

22. An actual and justiciable controversy has arisen between Plaintiff and Defendants herein as to whether the imposition by Defendants of worldwide unitary income taxation upon Plaintiff and its subsidiaries is lawful.

23. Plaintiff seeks a judgment herein declaring that the imposition by Defendants of such worldwide unitary income taxation is void and unenforceable as repugnant to the Constitution of the United States.

WHEREFORE, Plaintiff demands judgment in its favor and against all Defendants as follows:

(a) Preliminarily and permanently enjoining and restraining Defendants, and each of them, and their successors in office, and all persons acting in concert with them, from assessing, levying or collecting any tax upon Plaintiff's subsidiary, AlcanCorp, the amount of which is determined, in whole or in part, by reference to the worldwide income of Plaintiff;

(b) Declaring that the imposition by Defendants of such worldwide unitary income taxation is void and unenforceable;

(c) Declaring that Defendants' imposition of such worldwide unitary income taxation violates the Constitution of the United States;

(d) Awarding Plaintiff its costs and disbursements of this action; and

(e) Granting Plaintiff such other and further relief as the Court deems just and proper.

/s/ Lawrence A. Salibra, II  
LAWRENCE A. SALIBRA, II

/s/ Peter D. Miller  
PETER D. MILLER

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UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF ILLINOIS  
EASTERN DIVISION

ALCAN ALUMINIUM LIMITED, ) No. 84-C-6932  
Plaintiff, ) (Judge Marshall)

v. )

THE FRANCHISE TAX BOARD ) NOTICE OF  
OF THE STATE OF CALIFORNIA, ) MOTION AND  
operating through its Chicago ) MOTION TO  
office; Leonard Wilson, individu- ) DISMISS ACTION;  
ally and as District Manager, Chi- ) POINTS AND  
ago Office of the Franchise Tax ) AUTHORITIES  
Board of the State of California; ) IN SUPPORT  
and B. M. Rarang, individually ) THEREOF  
and as Auditor, Chicago Office of )  
The Franchise Tax Board of the )  
State of California, )

Defendants. )

---

TO: PLAINTIFF AND ITS ATTORNEYS OF RECORD:

PLEASE TAKE NOTICE that the defendants will move this Court at the courtroom of Judge Marshall, located in the United States Court House, 219 South

Dearborn Street, Chicago, Illinois 60604 on October 11, 1984, at 9:30 a.m. of that day, or as soon thereafter as counsel may be heard, on behalf of defendants above named for an order pursuant to rule 12(b) of the Federal Rules of Civil Procedure dismissing this action on the grounds that:

1. The court lacks jurisdiction over the subject matter.
2. The doctrines of res judicata and collateral estoppel bar plaintiff from relitigating the same issues resolved in the Second Circuit.
3. Plaintiff has no standing to institute this action.
4. There are two cases pending in two separate California state superior courts involving the identical issues raised in this action, brought by plaintiff's subsidiary corporation.
5. The complaint fails to state a claim upon which relief can be granted.

This motion is based upon the notice of motion filed herein, the points and authorities attached to this motion and the complaint of plaintiff on file herein, together with all other documents in the files of this Court.

DATED: September 4, 1984.

Respectfully submitted,  
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 Attorney General  
 of the State of California  
 EDWARD P. HOLLINGSHEAD  
 Deputy Attorney General

CHARLES C. KOBAYASHI  
 Deputy Attorney General  
 Attorneys for Defendants  
 Franchise Tax Board

---

IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF ILLINOIS  
EASTERN DIVISION

IMPERIAL CHEMICAL	:	
INDUSTRIES PLC,	:	
	:	Plaintiff,
	:	
v.	:	Civil Action No.
	:	84C8906
FRANCHISE TAX BOARD OF	:	
THE STATE OF CALIFORNIA,	:	
operating through their Chicago	:	COMPLAINT
office; and LEONARD WILSON,	:	
individually and as District Man-	:	
ager, Chicago Office of the State of	:	
California,	:	
	:	Defendants.

Plaintiff, Imperial Chemical Industries PLC, by its attorneys, James M. Carter, John B. Lowry, and Sidley & Austin, for its complaint, alleges that:

I.

1. Imperial Chemical Industries PLC ("Plaintiff") is a publicly held, capital stock, company (corporation) existing under the laws of England. Its headquarters and principal place of business is in England (United Kingdom). Plaintiff has, in addition, more than 300 subsidiaries and affiliates that manufacture in more than forty nations and maintain substantial sales organizations in more than sixty nations.

2. At all times relevant, Plaintiff and its subsidiaries engaged in manufacturing or extraction of ten separate product categories: Agricultural chemicals, crude petroleum and refinery products, general (heavy) chemicals,

industrial explosives (Nobel's), organic chemicals, paint and decorative products, petrochemicals, pharmaceuticals, plastics, and synthetic textiles. Manufacture and sale of each product category is operated as a separate business through largely autonomous divisions in the United Kingdom and through separate overseas subsidiaries for each nation. Each product category business has individual organization, structure, and operating procedures. Plaintiff is customarily ranked fourth largest amongst worldwide manufacturing companies engaged in similar businesses by the financial reporting services.

3. Plaintiff and its foreign (to the United States) subsidiaries do not do business in the State of California. At all times relevant, Plaintiff has not maintained a permanent establishment in the United States, nor has any of its foreign (to the United States) subsidiaries maintained a United States permanent establishment.

II.

4. ICI Americas Inc. ("Americas") is a corporation organized and existing under the laws of the State of Delaware. Its corporate headquarters and principal place of business is Wilmington, Delaware. Plaintiff has indirectly owned all of the issued and outstanding stock of Americas since 1971.

5. At all times relevant, Americas and its subsidiaries engaged in manufacturing or selling six of the ten product categories manufactured and sold by Plaintiff and its subsidiaries. These product categories are: Agricultural chemicals, decorative products (excluding

paints), organic chemicals, petrochemicals, pharmaceuticals and plastics. Americas, in addition, manufactures and sells security devices and various aerospace components. At all times relevant, the gross sales of Americas, all of which are subject to Federal income tax as United States source income, have not exceeded 1/15th of the total worldwide sales of Plaintiff and its subsidiaries.

6. Americas conducts certain of its business operations in the State of California and is duly qualified to do business within the State of California. Americas maintains manufacturing facilities and experimental stations in California.

### III.

7. Defendants, Franchise Tax Board, are an agency of the State of California. Defendants have the power and duty to administer the Bank and Corporation Tax Law of the State of California, *Cal. Gov. Code* §15700 and §15701 and *Cal. Rev. & Tax Code* §26422, as well as other provisions of the laws of California respecting taxation ("California Tax Law"). Defendants administer California Tax Law through permanent offices for the transaction of official business maintained in Chicago, Illinois, and New York, New York, as well as in California. Defendant Leonard Wilson is District Manager of the Chicago office located within the Eastern Division of the United States Northern District of Illinois.

### PLAINTIFF'S FIRST CLAIM FOR RELIEF

8. Defendants have, since 1971, computed and assessed taxes not solely upon California's apportioned share of income of Americas (all of which is derived from United States sources) but on an apportioned share of the total income of Plaintiff and Plaintiff's subsidiaries, including Americas. That method of taxation is generally designated "worldwide unitary income taxation." Defendants, in effect, required combined reporting of Plaintiff's worldwide income with Americas' (United States source) income for purposes of California income taxation.

9. Neither Plaintiff nor any of its foreign (to the United States) subsidiaries are persons subject to the taxing jurisdiction of California. Neither Plaintiff nor any of its foreign (to the United States) subsidiaries are persons subject to United States income taxes. Plaintiff and each of its subsidiaries paid or will pay taxes on taxable income to each host country during all times relevant. Utilizing Plaintiff's "worldwide unitary income" as a base for taxation imposes a California tax upon Plaintiff and its foreign (to the United States) subsidiaries. The actions of Defendants, in imposing worldwide unitary income taxation upon Plaintiff purport to have been and to be taken under authority of California Tax Law, and, therefore, violate the Foreign Commerce Clause of the United States Constitution, Art. I, §8.

10. The United States, the United Kingdom, and all jurisdictions in which Plaintiff and its subsidiaries do business, with the sole exception of California, impose income taxes on Plaintiff and its subsidiaries by the "arm's length pricing method" described in 26 U.S.C.

§482. No other State of the United States has imposed or has threatened to impose taxes on Plaintiff based on "worldwide unitary income taxation." As a result of Defendants' method of computing taxes, Plaintiff has been required to incur administrative and financial burdens and continues to be under such burdens.

11. The imposition by Defendants of "worldwide unitary income taxation" upon Plaintiff and its subsidiaries, therefore, constitutes impermissible double taxation and interferes with the foreign commerce of the United States and the commerce of other nations in violation of the Foreign Commerce Clause of the United States Constitution, Art. I, §8.

12. Plaintiff seeks to have defendants enjoined from imposing "worldwide unitary taxation" upon Plaintiff and its subsidiaries. Plaintiff has been and will be irreparably injured by the actions of Defendants described above unless Defendants are enjoined and restrained by this Court. Plaintiff does not have an adequate remedy at law.

13. This action arises under the Supremacy and Foreign Commerce Clauses of the Constitution of the United States. This Court, accordingly, has jurisdiction over the subject matter pursuant to 28 U.S.C. §1331, §1337, §1343 and §2201. The amount in controversy herein exceeds \$10,000, exclusive of interest and costs.

14. Defendants maintain an office and do business within this District. Venue is properly laid in this District pursuant to 28 U.S.C. §1391(b).

## PLAINTIFF'S SECOND CLAIM FOR RELIEF

15. Plaintiff repeats the allegations of paragraphs 1 through 14 in full.

16. An actual and justiciable controversy has arisen between Plaintiff and Defendants whether imposition by Defendants of "worldwide unitary income taxation" upon Plaintiff and its subsidiaries is lawful.

17. Plaintiff seeks judgment declaring that imposition by Defendants of "worldwide unitary income taxation" upon Plaintiff and its subsidiaries is void and unenforceable as repugnant to the Constitution of the United States.

WHEREFORE, Plaintiff demands judgment in its favor and against all Defendants as follows:

(a) Preliminarily and permanently enjoining and restraining Defendants, and each of them, and their successors in office, and all persons acting in concert with them, from assessing, levying or collecting any tax, the amount of which is determined, in whole or in part, by reference to the worldwide income of Plaintiff and its subsidiaries

(b) Declaring that the imposition by Defendants of such "worldwide unitary income taxation" upon Plaintiff and its subsidiaries and affiliates is void and unenforceable;

(c) Declaring that imposition by Defendants of "worldwide unitary income taxation" upon Plaintiff and its subsidiaries violates the Constitution of the United States;

(d) Awarding Plaintiff its costs and disbursements of this action; and

(e) Granting Plaintiff such other and further relief as the Court deems just and proper.

/s/ James M. Carter  
 James M. Carter  
 Law Department  
 ICI Americas Inc.  
 Wilmington, DE 19897  
 (302) 575-3738

/s/ John B. Lowry  
 John B. Lowry  
 McCutchen, Doyle, Brown &  
 Enersen  
 Three Embarcadero Center  
 San Francisco, CA 94111  
 (415) 393-2155

/s/ Maureen W. Fairchild  
 - Sidley & Austin  
 One First National Plaza  
 Chicago, IL 60603  
 (312) 853-7706

Attorneys for Plaintiff

---

JOHN K. VAN DE KAMP, Attorney General  
 of the State of California  
 EDWARD P. HOLLINGSHEAD  
 Deputy Attorney General  
 CHARLES C. KOBAYASHI  
 Deputy Attorney General  
 1515 K Street, Suite 511  
 Sacramento, California 95814  
 Telephone: (916) 324-5154  
 Attorneys for all Defendants

UNITED STATES DISTRICT COURT  
 NORTHERN DISTRICT OF ILLINOIS  
 EASTERN DIVISION

IMPERIAL CHEMICAL	) No. 84-C-8906
INDUSTRIES PLC,	) (Judge Plunkett)
	)
Plaintiff,	) NOTICE OF MOTION
	) FOR BRIEFING
v.	) SCHEDULE AND FOR
	) MOTION TO DISMISS
THE FRANCHISE TAX	) ACTION; POINTS
BOARD OF THE STATE OF	) AND AUTHORITIES
CALIFORNIA, operating	) AND DECLARATION
through their Chicago office;	) IN SUPPORT
and LEONARD WILSON,	) THEREOF
individually and as District	)
Manager, Chicago Office of	) Date: Jan. 18, 1985
the State of California,	) Time: 3:00 p.m.
	) Place: Judge
Defendants.	) Plunkett's
	) Courtroom

---

TO: PLAINTIFF AND ITS ATTORNEYS OF RECORD:

PLEASE TAKE NOTICE that the defendants will move this Court at the courtroom of Judge Plunkett, located in the United States Court House, 219 South Dearborn Street, Chicago, Illinois 60604 on January 18, 1985, at 3:00 p.m. of that day, or as soon thereafter as counsel may be heard, on behalf of defendants above named, for a motion call for a briefing schedule for defendants' motion for an order pursuant to rule 12(b) of the Federal Rules of Civil Procedure dismissing this action on the grounds that:

1. The court lacks jurisdiction over the subject matter.
2. Plaintiff has no standing to institute this action.
3. The complaint fails to state a claim upon which relief can be granted.
4. The court should abstain.

This motion is based upon the notice of motion filed herein, the points and authorities attached to this motion and the complaint of plaintiff on file herein, together with all other documents in the files of this Court.

DATED: January 8, 1985

Respectfully submitted,  
 JOHN K. VAN DE KAMP,  
 Attorney General  
 of the State of California  
 EDWARD P. HOLLINGSHEAD  
 Deputy Attorney General  
 CHARLES C. KOBAYASHI  
 Deputy Attorney General  
 Attorneys for Defendants  
 Franchise Tax Board

---

IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF ILLINOIS  
EASTERN DIVISION

ALCAN ALUMINIUM	)	
LIMITED,	)	
	)	
Plaintiff,	)	No. 84 C 6932
	)	
v.	)	
	)	
THE FRANCHISE TAX	)	
BOARD OF THE STATE OF	)	
CALIFORNIA, etc., et al.,	)	
	)	
Defendants.	)	

MEMORANDUM OPINION

Prentice H. Marshall, District Judge

Plaintiff Alcan Aluminium Ltd. alleges that the State of California's worldwide unitary taxation program, administered by defendants, the Franchise Tax Board of the State of California (the Board) and certain representatives of the Board, violates the Foreign Commerce Clause of the United States Constitution. Worldwide unitary taxation imposes a tax obligation based upon the income of all companies the Board determines are engaged in a single or unitary enterprise. Defendants have moved to dismiss on the grounds of collateral estoppel, lack of standing, and abstention.

Plaintiff, a Canadian corporation, owns approximately one hundred subsidiaries outside the United States. Neither plaintiff nor any of its foreign subsidiaries conducts business in the United States. Plaintiff also owns Alcan Aluminum Corp. (Alcancorp), a New York

corporation with its principal place of business in Cleveland, Ohio. Alcancorp conducts business in California and is subject to the unitary business income tax.

The Board maintains an office in Chicago, and the two individual defendants operate out of the Board's Chicago office. For the purposes of determining Alcancorp's unitary income, defendants have required plaintiff to provide information relating to the activities of plaintiff's foreign subsidiaries, a requirement which has burdened plaintiff financially. According to the complaint, imposition of the unitary income tax burdens not only Alcancorp, but plaintiff and its foreign subsidiaries as well.

In 1981 plaintiff sued the Board and certain agents of the Board based upon the unitary income tax applied to Alcancorp, in the United States District Court for the Southern District of New York. In that action the court held that plaintiff, as a parent corporation, lacked standing to contest the taxation of Alcancorp, its subsidiary, *Alcan Aluminum Ltd. v. Franchise Tax Board of the State of California*, 558 F. Supp. 624 (S.D. N.Y. 1983) (*Alcan I*). The Second Circuit affirmed the decision, *Alcan Aluminum Ltd. v. Franchise Tax Board of the State of California*, No. 83-7236 (2d Cir. June 17, 1983), and the Supreme Court denied certiorari, 104 S. Ct. 1457 (1984). Defendants argue that the result in *Alcan I* precludes plaintiff from relitigating the standing issue.

The Supreme Court has held that a judgment holding a particular tax assessment invalid does not collaterally estop collection of the same tax in a later year when there

has been intervening authority which supersedes or repudiates the original decision. *Limbach v. Hooven & Allison Co.*, 104 S. Ct. 1837 (1984); *Commissioner v. Sunnen*, 333 U.S. 591 (1954). Similarly, collateral estoppel should not bar an action challenging imposition of a tax when there is superseding law.

Since *Alcan I*, the court of appeals for this circuit has indicated that a parent corporation has standing to challenge imposition of unitary business income tax on its subsidiary when the parent alleges that the tax burdens its foreign commerce:

[Parent] has alleged an independent injury as a basis for standing. It claims an unconstitutional burden on its foreign commerce. If [parent's] allegations as to its standing are accepted as true its interests and those of [subsidiary] are not identical. . . . Thus, [subsidiary's] state remedy does not protect appellant fully. As soon as the tax is assessed against [subsidiary], the threat of injury to appellant will be immediate. Nothing in the Tax Injunction Act requires [parent] to wait while [subsidiary] pursues its own remedies under Oregon law for its own injury.

*Alcan Aluminium Limited v. Department of Revenue of the State of Oregon*, 724 F. 2d 1294, 1299 (7th Cir. 1983). The court of appeals affirmed the dismissal of the action, however, because the tax had not yet been assessed, and, therefore, the case was not ripe.

To apply collateral estoppel as a bar to this action would mean that companies similarly situated to plaintiff could challenge this tax in this circuit, but that plaintiff could not. Collateral estoppel should not be applied to result in such inequality. Further, there is some authority that collateral estoppel should not be applied in a circuit

which has adopted a contrary rule of law. *United States v. Stauffer Chemical Co.*, 104 S. Ct. 575, 582 (1984) (White, J., concurring opinion).

The Seventh Circuit has recognized that if plaintiff's allegations are true, plaintiff suffers an independent injury from the unitary business tax, and therefore, has standing to contest the constitutionality of the tax. Accordingly, collateral estoppel does not bar this action.

Finally, defendants argue that we should abstain from hearing this action while AlcanCorp pursues a refund action in the California courts. Such an action is now pending in the Los Angeles County Superior Court. Defendants assert that the factual determinations made by the California court as to whether plaintiff and AlcanCorp are a unitary business may obviate the need to decide the constitutional issues presented in this action. Plaintiff, however, is not a party to the California action. Because plaintiff is not directly taxed, it has no state remedy to exhaust to gain relief from the tax. The state refund action does not fully protect plaintiff's interests. Plaintiff's only remedy is to contest the constitutionality of the tax. Consequently, abstention to an action in which plaintiff is not a party is inappropriate.

Defendant's motion to dismiss is denied. Defendant to answer the complaint within twenty days of the entry of this order.

ENTER:

/s/ Prentice H. Marshall  
Prentice H. Marshall  
District Judge

DATED: January 10, 1985.

January 29, 1985

(916) 324-5154

United States District Court  
Northern District of Illinois  
Eastern Division  
219 South Dearborn Street  
Chicago, IL 60604

Attention: Clerk for Hon. Prentice Marshall

Dear Madam:

Imperial Chemical Industries PLC v.  
The Franchise Tax Board of the State  
of California - No. 84-C8906

Please take off calendar the defendants' motion to dis-  
miss in the above matter, which was consolidated with  
*Alcan Aluminium Limited v. Franchise Tax Board, et al.*, No.  
84-C-6932.

Thank you for your attention to this request.

Very truly yours,

JOHN K. VAN DE KAMP  
Attorney General

CHARLES C. KOBAYASHI  
Deputy Attorney General

CCK:rm

cc: James M. Carter, Esq.  
John B. Lowry, Esq.  
Sidley & Austin

JOHN K. VAN DE KAMP, Attorney General  
of the State of California  
EDWARD P. HOLLINGSHEAD  
Deputy Attorney General  
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1515 K Street, Suite 511  
Sacramento, California 95814  
Telephone: (916) 324-5154

Attorneys for Defendants

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF ILLINOIS  
EASTERN DIVISION

ALCAN ALUMINIUM	) Civ 84 C 6932
LIMITED,	)
	) (Judge Marshall)
Plaintiff,	)
	)
v.	)
THE FRANCHISE TAX	) ANSWER TO
BOARD OF THE THE	) COMPLAINT
STATE OF CALIFORNIA,	)
operating through its Chi-	)
cago Office; LEONARD	)
WILSON, individually and	)
as District Manager, Chi-	)
cago Office of the FRAN-	)
CHISE TAX BOARD OF	)
THE STATE OF CALIFOR-	)
NIA; and B.M. RARANG,	)
individually and as Audi-	)
tor, Chicago Office of the	)
FRANCHISE TAX BOARD	)
OF THE STATE OF	)
CALIFORNIA,	)
	)
Defendants.	)

Defendants answer plaintiff's complaint as follows:

1. Defendants are without knowledge or information to form a belief as to the truth of the allegations contained in paragraphs 1, 2, 3 and 4.

2. Defendants deny generally and specifically the allegations in the last sentence of paragraph 11.

3. Defendants deny generally and specifically the allegations of paragraph 13 except that they admit that the Franchise Tax Board has assessed taxes against Alcan-corp on a worldwide unitary basis.

4. Defendants deny the allegations of paragraph 12 except that they admit that an audit of Alcan-corp is presently in progress at some stage.

5. Defendants deny generally and specifically the allegations in paragraphs 14, 15, 17, 18, 19, 20, 22 and 23.

6. Defendants are without knowledge of information to form a belief as to the truth of the allegations contained in paragraph 16 except that they deny generally and specifically the allegations in the last sentence of said paragraph 16.

7. Defendants reallege their answers to paragraphs 1 through 20 of the complaint and incorporate them by reference as if set forth in full in answer to paragraph 21.

#### AFFIRMATIVE DEFENSES

The complaint fails to state a claim upon which relief can be granted in that:

8. Plaintiff has no standing under article III of the United States Constitution to institute this action.

9. The Eleventh Amendment of the United States Constitution bars this action.

10. No injunction or declaratory judgment may be granted which prevents or enjoins the assessment or collection of state taxes.

11. The amount in controversy does not exceed \$10,000.00.

12. The doctrine of abstention bars this action.

13. The doctrines of res judicata or collateral estoppel bar plaintiff from relitigating the same issues resolved in the Second Circuit.

14. This Court has no jurisdiction over the subject matter of this action.

WHEREFORE, defendants pray that plaintiff take nothing by its complaint and that they be awarded their costs of suit and such other and further relief as the court deems proper.

DATED: January 29, 1985.

JOHN K. VAN DE KAMP, Attorney  
General of the State of California  
EDWARD P. HOLLINGSHEAD  
Deputy Attorney General

/s/ Charles C. Kobayashi  
CHARLES C. KOBAYASHI  
Deputy Attorney General

Attorneys for Defendants

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1515 K Street, Suite 511  
Sacramento, California 95814  
Telephone: (916) 324-5154  
Attorneys for Defendants

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF ILLINOIS  
EASTERN DIVISION

IMPERIAL CHEMICAL	)	No. Civ 84 C 6932
INDUSTRIES,	)	(Formerly 84 C
	)	8906)
Plaintiff,	)	
	)	
v.	)	(Judge Marshall)
	)	
FRANCHISE TAX BOARD	)	
OF THE STATE OF CALI-	)	
FORNIA, operating	)	ANSWER TO
through its Chicago Office;	)	COMPLAINT
and LEONARD WILSON,	)	
individually and as District	)	
Manager, Chicago Office of	)	
the State of California.	)	
	)	
Defendants.	)	

Defendants answer plaintiff's complaint as follows:

1. Defendants are without knowledge or information to form a belief as to the truth of the allegations contained in paragraphs 1, 2, 3, 4 and 5.

2. Defendants deny generally and specifically the allegations in the next to the last sentence of paragraph 7.

3. Defendants deny generally and specifically the allegations of paragraph 8 except that they admit that the Franchise Tax Board has assessed taxes against Americas on a worldwide unitary basis.

4. Defendants are without knowledge or information to form a belief as to the truth of the allegations contained in paragraph 9 except that they deny generally and specifically the allegations in the last two sentences of said paragraph 9.

5. Defendants are without knowledge or information to form a belief as to the truth of the allegations contained in paragraph 10 except that they deny generally and specifically the allegations in the last sentence of said paragraph 10.

6. Defendants deny generally and specifically the allegations in paragraphs 11, 12, 13, 16 and 17.

7. Defendants reallege their answer to paragraphs 1 through 14 of the complaint and incorporate them by reference as if set forth in full in answer to paragraph 15.

#### AFFIRMATIVE DEFENSES

The complaint fails to state a claim upon which relief can be granted in that:

8. Plaintiff has no standing under article III of the United States Constitution to institute this action.

9. The Eleventh Amendment to the United States Constitution bars this action.

10. No injunction or declaratory judgment may be granted which prevents or enjoins the assessment or collection of state taxes.

11. The amount in controversy does not exceed \$10,000.00.

12. The doctrine of abstention bars this action.

13. This Court has no jurisdiction over the subject matter of this action.

WHEREFORE, defendants pray that plaintiff take nothing by its complaint and they be awarded their costs of suit and such other and further relief as the court deems proper.

DATED: February 13, 1985.

JOHN K. VAN DE KAMP, Attorney  
General of the State of California  
EDWARD P. HOLLINGSHEAD  
Deputy Attorney General

CHARLES C. KOBAYASHI  
Deputy Attorney General  
Attorneys for Defendants

---

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF ILLINOIS  
EASTERN DIVISION

IMPERIAL CHEMICAL	)	No. 84-C-8906
INDUSTRIES PLC	)	(Judge Williams)
	)	
Plaintiff,	)	
	)	JOINT STIPULATION
v.	)	OF FACTS
	)	
THE FRANCHISE TAX	)	
BOARD OF THE STATE OF	)	
CALIFORNIA, operating	)	
through its Chicago office;	)	
and LEONARD WILSON,	)	
individually and as District	)	
Manager, Chicago Office of	)	
the State of California	)	

IT IS STIPULATED AND AGREED by the parties through their respective counsel that:

This stipulation shall not be construed as a concession by any party of relevance and materiality of any of the facts herein recited, and the parties expressly reserve the right to argue the relevancy or materiality of any of the facts herein recited.

Exhibits attached are included by reference and may be entered into evidence as facts except as expressly provided herein.

This stipulation shall apply only in the above-entitled action and in any appeal from the judgment of this Court.

The following facts are agreed and undisputed and may be treated by the Court as facts proven in open court.

1. Plaintiff Imperial Chemical Industries PLC ("ICI") is an English public limited company having its principal office and place of business in London, England. ICI does not maintain a place of business in the United States or any of its Possessions or Territories. ICI does have an office in New York, which office is used by company officials when in the United States on business. ICI does not do business in California and is not subject to the California Bank and Corporation Tax Law.

2. ICI is a publicly held company listed on the London Stock Exchange, having approximately 350,000 shareholders owning 619 million ordinary shares (common stock) with an equity value of some 3,800 million pounds sterling. ICI's 1984 Financial Statement is attached as Exhibit 1. ICI ordinary shares are also traded on the New York Stock Exchange in the form of American Depositary Receipts, each Receipt representing two ordinary shares on the London Stock Exchange. Attached as Exhibit 2-1 and 2-2 are copies of ICI's Forms 20-F which were filed, as required, with the U.S. Securities and Exchange Commission for years ended December 31, 1983 and 1984. Forms 20-F have been filed for previous years by ICI.

3. The business activities of ICI and its subsidiaries in Western Europe comprise thirteen principal business groupings. The main product lines of each are:

<i>Business</i>	<i>Main Product Lines</i>
Agricultural	Fertilizers, ammonia, methanol
Agrochemicals and Colours	Herbicides; pesticides; dyes; pigments

Fibres	Synthetic fibres
General Chemicals	General and heavy chemicals; alkalis; chlorine, fluorine, and derivatives; soda ash
Industrial Explosives	Industries explosives and accessories
Oil	Crude oil and gas
Organics	Dyes, nitrocellulose, silicone, biocides, polyurethanes
Paint	Paints and industrial coatings
Petrochemicals and Plastics	Petroleum derivatives; basic materials for plastics: ethylene, propylene, butadiene; polymers, acrylics
Pharmaceuticals	Drug and Pharmaceuticals for human and animal use
Polyurethanes	Polyurethanes
Plant Protection	Herbicides, pesticides, biocides
Speciality Chemicals and Materials	Silicones; biocides; surfactants; resins; composite materials

The Agrochemicals, Pharmaceuticals, and Oil businesses operate on a worldwide basis.

4. ICI owns, directly or indirectly, 50% or more of the following principal manufacturing subsidiaries in nations foreign to the United Kingdom:

<i>Nation</i>	<i>Company</i>
Canada	C-I-L Inc.
Argentina	Duperial S.A.I.C.
United States	ICI Americas Inc.
Malaysia	Chemical Company of Malaysia Berhad
Australia	ICI Australia Ltd. Incitec Ltd.
Japan	ICI Japan Ltd. ICI-Pharma Ltd.
New Zealand	ICI New Zealand Ltd.
Pakistan	ICI Pakistan Manufacturers Ltd.
India	Indian Explosives Ltd.

A list of principal "subsidiaries" (over 50% ownership) and "associated companies" (between 20% and 50% ownership) as of December 31, 1984, showing nation in which organized and products manufactured or supplied is attached as Exhibit 3. This is not complete as there are about 400 subsidiaries and about 100 associated companies. Hereinafter, ICI and its worldwide subsidiaries (over 50% ownership) will be referred to as the "ICI Group."

5. In 1984, the ICI Group reported gross sales worldwide, eliminating intercompany trading, of 9,909 million pounds sterling. Of this amount, 6,774 million pounds sterling was derived from sales in nations other than the United Kingdom. In 1984 gross sales in the United States by ICI Americas Inc. ("ICI Am") and subsidiaries were approximately U.S. \$1,400 million (1,208

million pounds sterling). ICI Am is the principal operating subsidiary of ICI in the United States. ICI Am makes export sales out of the United States. Attached as Exhibit 4 is an affidavit by the Controller of ICI, B.D. Romeril, showing the distribution of sales, property, and payroll for the ICI worldwide group of Companies compared to the United States sales, property, and payroll for the years 1981 through 1984. By this stipulation, the Defendant does not endorse the examples in paragraph 8 of Mr. Romeril's affidavit relating to translating foreign currencies into sterling equivalents and sterling into dollar equivalents. All of ICI Am's income is taxable for federal income tax purposes and is classified as U.S. source income under the Internal Revenue Code.

6. ICI Am (formerly ICI United States, Inc. and Atlas Chemical Industries), the entity subject to California taxation, is a Delaware corporation. During the period 1971 through 1981, ICI Am conducted business in California through ownership\* and operation of a pharmaceutical manufacturing plant in Pasadena and other business activities. ICI Am was at all relevant times a subsidiary of ICI American Holdings Inc., a wholly owned subsidiary of ICI. ICI American Holdings Inc. is a Delaware corporation that does not and never did conduct any business in California. The sole activity of ICI American Holdings Inc. was holding stock in subsidiary corporations and exercising certain stewardship functions of ownership.

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\* The plant and property were actually owned by ACI Realty Corporation, a Delaware Corporation, wholly owned by ICI Am.

7. In July 1971, the stock of Atlas Chemical Industries, Inc., a Delaware corporation, was acquired by ICI Am. Atlas was liquidated on September 30, 1971. At that time, ICI Am became the parent of a number of Atlas foreign subsidiaries, the principal ones of which were:

<i>Name</i>	<i>Nationality</i>
Atlas Europol S.A.	Italy
Atlas Chemical Industries, S.A.	Belgium
Atlas Taiwan Ltd.	Taiwan
Atlas Honeywell Ltd.	England
Atlas Canada Limited	Canada
Atlas Quimicas Industries, S.A.	Nicaragua
Atlas Mexico, S.A.	Mexico
Atlas Chemie G.m.B.H.	West Germany

By September 30, 1975, all of those subsidiaries had been liquidated or sold by ICI Am to ICI or third parties. For purposes of this litigation, no issue is raised as to the correctness of including these subsidiaries in the combined report used to calculate ICI Am's income attributable to California. ICI Am has not had foreign subsidiaries or foreign operations since 1975 except for a limited amount of export sales to foreign countries.

8. ICI Am conducts the following activities in California at the present time (1985):

Stuart Pharmaceutical Plant, 378 employees.

Signal Hill Research Facility, 5 employees.

Visalia Agricultural Research Facility,

11 employees.

ARBCO Electronic Plant, 112 employees.

LNP Corp., 71 employees.

The ARBCO plant was acquired in 1983. LNP Corp. was acquired March 31, 1984. The Stuart (Pasadena) facility has been operated by ICI Am since September 1, 1971, the date ICI Am acquired the stock and properties of Atlas Chemical Industries, Inc.

9. Defendant, The Franchise Tax Board of the State of California ("Board"), is an official agency of the state. The Board's responsibilities include administration, collection and enforcement of the state's corporate income and franchise taxes. The Board's agents conduct taxpayer audits and make redeterminations of taxes based on taxpayer returns and accounting information, taxpayer records, and other informational sources. The Board maintains offices in Chicago, Illinois, as well as in several other cities. The Board's audit of ICI Am was conducted through its offices in New York City and San Diego, California. No audit of ICI Am has been conducted by the Board through its Chicago office.

10. For the income years ending 1972 through 1981, ICI Am filed with the Board California franchise tax returns. For those years in which ICI Am reported net income it apportioned income to California on the basis of a three-factor formula, using California property, California payroll and California sales as the numerators and all property, payroll and sales of ICI Am as the denominators. For those years in which ICI Am reported a loss it filed a return reflecting such loss but provided no information on its apportionment factors.

11. During the income years ended September 30, 1972 through December 31, 1981, ICI Am's California property, payroll, and sales, as defined for purposes of the California apportionment formula (Cal. Rev. & Tax. Code Section 25120 et seq.), assignable to California and reported on the California return or derived from ICI Am's books and records, were for each year as follows (expressed in dollars):

	<i>Property</i>	<i>Payroll</i>	<i>Sales</i>
Sept. 30, 1972	10,512,000	4,739,000	12,961,000
Sept. 30, 1973	10,649,000	3,351,000	15,312,000
Sept. 30, 1974	11,438,000	3,616,000	18,431,000
Sept. 30, 1975	13,304,000	4,259,000	19,734,000
Dec. 31, 1975	12,396,000	1,194,000	5,960,000
Dec. 31, 1976	12,407,274	5,179,530	29,378,661
Dec. 31, 1977	13,454,102	5,947,292	34,217,864
Dec. 31, 1978	15,291,997	6,564,559	51,351,332
Dec. 31, 1979	21,165,773	7,486,820	58,670,968
Dec. 31, 1980	23,592,346	7,878,572	70,022,943
Dec. 31, 1981	23,229,096	8,885,877	71,238,012

12. ICI Am's reported calculation of taxes paid to the Board, net of credits, for the years 1972 through 1981 was as follows (expressed in dollars):

<i>Income Year Ending</i>	<i>ICI Am Total Bus. Inc.</i>	<i>Cal. Apport. Factor (%)</i>	<i>Cal. Bus. Income</i>	<i>Tax Rate</i>	<i>Tax</i>
Sept. 30, 1972	(6,819,633)	-	-	min.	100
Sept. 30, 1973	(27,434,974)	-	-	min.	200
Sept. 30, 1974	19,540,882	3.9248	699,722	9.0	62,975
Sept. 30, 1975	10,974,668	4.4176	484,455	9.0	43,600
Dec. 31, 1975	(2,038,420)	5.1430	-	min.	200
Dec. 31, 1976	17,393,771	5.2894	920,010	9.0	82,801
Dec. 31, 1977	25,926,761	5.0830	1,315,564	9.0	118,401
Dec. 31, 1978	41,416,104	5.2357	2,166,422	9.0	194,978
Dec. 31, 1979	2,795,678	5.0342	147,640	9.0	13,287
Dec. 31, 1980	6,021,966	5.1912	311,757	9.0	28,058
Dec. 31, 1981	17,475,583	4.9449	869,057	9.6	83,429

13. For the income years ending 1972 through 1981, the Board has conducted audits of the California franchise tax returns of ICI Am. Upon audit the Board determined that ICI Am was part of a unitary enterprise conducted by all members of the ICI Group.

14. Based upon its determination that ICI Am was part of a worldwide unitary business conducted by the ICI Group, the Board computed ICI Am's net income subject to California tax by applying the unitary apportionment method of accounting, using as the apportionment base the worldwide income of the ICI Group.

15. The unitary apportionment method of accounting as used by the Board is a method of determining the amount of income of a particular taxpayer which is attributable to and taxable by California. Under this method, the results and activities of all commonly controlled entities which function as a single or unitary business are combined and a portion of such overall results is then assigned to California based upon a comparison of the activities conducted in California to the activities of the unitary business everywhere. This method involves essentially a three-step process, as follows:

(a) The first step in the process is to identify those corporate entities and activities which constitute a single unitary business.

(b) The second step is to determine the total income of the unitary business. This entails the elimination of all nonbusiness income of the unitary entities. Nonbusiness income is income which does not arise from the conduct of the unitary business (e.g., certain investment income).

(c) The third step is to apply an apportionment formula to the total business income of the unitary business. The apportionment formula is the average ratio of the activities of the individual taxpayer in California to the activities of the entire unitary business everywhere.

16. In apportioning a part of the total combined business income of the ICI Group to the activities conducted by ICI Am in California, the Board followed the provisions of the Uniform Division of Income for Tax Purposes Act ("UDITPA") as enacted by California.

17. The manner in which the individual apportionment fractions are computed is set forth in Regulations adopted by the Board (California Administrative Code, title 18, Sections 25129-25137). A copy of the current version of these administrative regulations, which are identical to those recommended by the Multi-state Tax Commission, is attached hereto as Exhibit 5.

18. The Board has also adopted a regulation (California Administrative Code, title 18, Reg. § 25137-6) which sets forth rules for the preparation of a combined report which includes foreign country operations. (A copy of the regulation is attached hereto as Exhibit 6.)

19. The Board's calculation of ICI Am's California tax liabilities, disregarding a credit not here at issue, for the years 1971 through 1981, was as follows:

	Business Income of Unitary Bus. in U.S. Dollars*	Cal. Apport. Factor %	Cal. Bus. Income (\$)	Tax Rate	Tax (\$)
Sept. 30, 1972	300,945,155	.3254%	979,276	7.45%	72,956
Sept. 30, 1973	559,403,136	.2540%	1,420,884	7.95%	112,960
Sept. 30, 1974	892,835,033	.2335%	2,084,770	9.0%	187,629
Sept. 30, 1975	751,667,365	.2825%	2,123,460	9.0%	191,111
Dec. 31, 1975	168,943,576	.2763%	466,791	9.0%	42,011
Dec. 31, 1976	892,094,114	.2922%	2,606,699	9.0%	234,603
Dec. 31, 1977	853,140,345	.3128%	2,668,623	9.0%	240,176
Dec. 31, 1978	878,282,236	.3738%	3,283,019	9.0%	295,472
Dec. 31, 1979	1,255,194,918	.3463%	4,346,740	9.0%	391,206
Dec. 31, 1980	604,695,081	.3273%	1,979,167	9.6%	190,000
Dec. 31, 1981	265,511,942	.3475%	922,654	9.6%	88,575

\* For convenience of the court, this table reflects worldwide income in U.S. dollars. However, as noted in the text, the actual computations were done in pounds sterling, with the amount of income apportioned to California computed in pounds sterling, which was then converted to U.S. dollars for purposes of computing the California tax, using average exchange rates for the year as published by the International Monetary Fund.

After the issuance by the Board of the Notices of Proposed Assessment and the filing by ICI Am of a protest, the Board agreed to reduce the above amounts for the years of 1976-1981, which erroneously included investment grants in income, to the following amounts:

Business Income of Unitary Bus. in U.S. Dollars*	Cal. Apport. Factor %	Cal. Bus. Income (\$)	Tax Rate	Tax (\$)
Dec. 31, 1976	.2922%	2,490,548	9.0%	224,152
Dec. 31, 1977	.3128%	2,548,505	9.0%	229,365
Dec. 31, 1978	.3738%	3,117,992	9.0%	280,619
Dec. 31, 1979	.3463%	4,207,145	9.0%	378,643
Dec. 31, 1980	.3273%	1,819,272	9.6%	174,650
Dec. 31, 1981	.3475%	511,343	9.6%	49,088

\* See footnote on preceding page.

20. The changes in ICI Am's California tax liability are largely the result of the determination by the Board that ICI Am was part of a unitary enterprise conducted by the ICI Group and that use of the unitary apportionment method of accounting was required to determine properly ICI Am's California taxable income.\*\* These adjustments generally resulted in an increase in California tax, but resulted in a reduction for 1981.

21. In computing the income attributable to ICI Am's California activities, the Board began with the consolidated income of the ICI Group as set forth in the financial statements contained in ICI's published annual reports and expressed in pounds sterling. Adjustments based on information contained in the published annual reports were made to eliminate exchange rate gains and losses, investment grants and the earnings of 50 percent or less owned corporations. Adjustments were made to the earnings of ICI Am to conform to California tax accounting. Nonbusiness income was eliminated (for 1976-1980, dividends from 50% or less owned subsidiaries were included as business income). Depreciation was reported by ICI Am on a straight-line basis for tax and book purposes and by the ICI Group on a straight-line basis for the financial statements contained in the annual reports.

22. The numerators of the factor fractions of the apportionment formula were supplied by ICI Am, with

\*\* Adjustments were also made, which are not in issue in this action, to increase the California sales over the amounts reported by ICI Am. These adjustments gave rise to increased California tax liabilities.

adjustments made to properly reflect sales assigned to California. These amounts were converted to pounds sterling, using average exchange rates for the year as published by the International Monetary Fund.

23. The denominators of the factor fractions of the apportionment formula were all derived from the published financial statements of the ICI Group in ICI's annual reports, expressed in pounds sterling, using average exchange rates for the year as published by the International Monetary Fund. Fixed assets (land, plant and equipment) are set forth on a consolidated basis in the annual reports, either at original cost or on a revalued basis. If assets are revalued, any changes are reflected in a revaluation reserve which is set forth in the ICI Group's consolidated financial statements. The inventory of the ICI Group is set forth in the annual reports. Because ICI Group rents were not available to be included in the denominator of the property factor, the Board eliminated rentals from the numerator and denominator of the property factor. ICI Group payroll and sales were taken directly from the published annual reports.

24. The California apportionment factor was calculated by averaging the three-factor fractions. The numerator and denominator of each of the fractions was expressed in pounds sterling. The apportionment factor was then applied to the worldwide business income of the ICI Group (as derived from the annual reports of ICI and expressed in pounds sterling). The result, business income apportioned to California, was translated into dollars at the average exchange rates for the year as published by the International Monetary Fund and the California tax was then calculated.

25. Attached hereto as Exhibits 7-1, 7-2, 7-3, 7-4, 7-5, 7-6, 7-7 and 7-8 are copies of the annual reports of ICI for the years 1974 through 1981.

26. Attached as exhibits are copies of correspondence between the Board and ICI Am relating to the audits, as follows:

<i>Date</i>	<i>Document</i>	<i>Ex. No.</i>
July 29, 1977	Questionnaire from Board	8
February 2, 1979	Letter from Board	9
February 27, 1979	Letter from ICI Am	10
March 5, 1984	Letter from Board	11
November 15, 1984	Letter from Board	12

27. The Board has not directed any correspondence to ICI or any member of the ICI Group other than ICI Am. All taxes assessed or proposed to be assessed by the Board were against ICI Am. The Board has not assessed or proposed to assess taxes against ICI or any member of the ICI Group other than ICI Am.

28. ICI Am has not petitioned the Board for the use of a different apportionment method under California Revenue and Taxation Code § 25137.

29. ICI Am paid the additional assessments for 1972-1975, and timely filed claims for refund with the Board protesting the calculation of ICI Am's California tax on the basis that it is part of a unitary business conducted by the ICI Group. A copy of ICI Am's statement of the grounds for refund is attached as Exhibit 13. ICI Am also has filed a protest of the proposed assessment, calculated on the same basis, for the years 1976

through 1981. ICI Am believes increased assessments for 1982, 1983 and 1984 are likely to be proposed by the Board on the same basis as earlier years.

30. For purposes of this litigation, plaintiff does not contest:

(a) the factual basis for the Board's determination that the ICI Group constituted a single unitary business under the laws of California and the tests formulated by the California courts;

(b) the factual correctness of the Board's application of the unitary method of accounting and combination of the income and apportionment factors of the ICI Group under the laws of California and the tests formulated by the California courts.

31. ICI collects and maintains data on the property, payroll, and sales of its subsidiaries in a summary form only. Detailed supporting data is maintained at the subsidiary level. Summary data is collected, aggregated and submitted by the subsidiaries as recorded on annual "T" Forms. Financial results are reported annually to ICI in London by its various worldwide subsidiaries on the "T" Forms, which are balance sheets and profit and loss statements conformed to U.K. accounting standards, with data that are not necessarily stated at calendar year ends, but normally at dates determined by the statutory accounting year of the subsidiary. Copies of the "T" Forms for the year 1980 prepared by ICI Am are attached as Exhibit 14-1 and 14-2. The "T Form" is the basic financial report submitted regularly to ICI by its worldwide subsidiaries.

32. There are differences in accounting principles and reporting practices among the United States and the various nations, including the United Kingdom, in which ICI operates through its subsidiaries worldwide. All subsidiaries of ICI submit necessary data for the preparation of yearly consolidated financial statements which conform to United Kingdom accounting practice. Attached as Exhibit 15 is a copy of the "International Survey of Accounting Principles and Reporting Practices" prepared by Price Waterhouse International (Scarborough, Ont. 1979).

33. Under date of August 31, 1984, the Secretary of the Treasury (United States) issued the Final Report of the "Worldwide Unitary Taxation Working Group." A copy of this report is attached as Exhibit 16. By this stipulation, the parties intend no endorsement of the views stated in Exhibit 16.

34. Attached as Exhibit 17-1 through 17-14 are statements from various foreign governments to the United States government expressing the views of these governments on unitary taxation by the states of the United States. By this stipulation, the parties intend no endorsement of the views stated in Exhibit 17. These statements are as follows:

17-1: Letter from Nigel Lawson, Chancellor of Exchequer, United Kingdom, to Secretary of Treasury dated July 12, 1983;

17-2: Note No. 51 from the British Embassy to the Department of State; Washington, D.C., dated March 25, 1980;

17-3: Note from the Embassy of Belgium to the Department of State dated January 25, 1984, attaching

memorandum of the Government of Belgium on Worldwide Unitary Taxation;

17-4: Aide-Memoire from the Japanese Government to the U.S. Government regarding unitary taxation dated June 6, 1984;

17-5: Note No. 634 from the Embassy of Canada to the Department of State, Washington, D.C., dated February 27, 1984;

17-6: Letter forwarding note from the Embassy of the Federal Republic of Germany to the Department of State, Washington, D.C., dated November 28, 1983;

17-7: Note from Embassies of the Member States of the European Community, the European Commission and the Embassies of Australia, Canada, Japan and Switzerland with appended signatures of the respective ambassadors to the Department of State, Washington, D.C., dated January 25, 1984;

17-8: Note EA-14533 from the Royal Netherlands Embassy to the Department of State, Washington, D.C., dated December 21, 1983;

17-9: Letter with note attached from the Belgian Embassy to the Department of State, Washington, D.C., dated June 29, 1982;

17-10: Note No. 283 from the Canadian Embassy to the Department of State, Washington, D.C., dated June 14, 1982;

17-11: Note No. 83 from the British Embassy to the Department of State, Washington, D.C., dated May 18, 1982;

17-12: Note No. 692 from the Canadian Embassy to the Department of State, Washington, D.C., dated December 22, 1981;

17-13: Note No. 211 from the British Embassy to the Department of State, Washington, D.C., dated October 30, 1981; and

17-14: Note No. 383/83 from the Embassy of Australia to the Department of State, Washington, D.C., dated November 7, 1983.

35. Attached as Exhibit 18 is a copy of the United Kingdom legislation and accompanying Parliamentary statements reflecting the passage of new Clause 27 to the Finance Bill of 1985. This legislation authorizes the United Kingdom Treasury to impose retaliatory measures on United States' companies doing business in unitary tax states. The United Kingdom Treasury has not at this date instituted any of the measures authorized.

36. A corporation of the United Kingdom is entitled under the laws of that country to a credit for foreign taxes paid on dividends of subsidiaries located in other countries and for foreign taxes paid on earnings out of which such dividends are paid. In some cases this credit extends to taxes levied by subnational jurisdictions such as California.

37. There is attached as Exhibit 19 an affidavit from the Inland Revenue, a branch of the Treasurer's office of the Government of the United Kingdom, showing the amount of tax credit allowable under English law to ICI for the California taxes assessed against ICI Am shown in Paragraph 19. By this stipulation, the Board does not accept the correctness of the characterization of the sources of income used for the California unitary method of taxation. By this stipulation, the parties intend no endorsement of the views stated in Exhibit 19. No California tax has been assessed directly against ICI.

38. There is attached as Exhibit 20 a table of monthly conversion rates to U.S. dollars from English

pounds, for the interval December 31, 1979 through August 30, 1985.

39. There is attached as Exhibit 21 a spread sheet showing a comparison of ICI and ICI Am book profits for the years 1972-1984.

40. ICI estimates that the additional administrative cost of preparing ICI Am's California franchise tax returns on a world-wide unitary basis would be two million pounds sterling initially, plus two million pounds sterling on an annual basis. Attached as Exhibit 22 is an affidavit by the Deputy Controller of ICI, Frederick Philip Gray, showing prospective reporting requirements and accounting adjustments and showing also the estimated cost of each such requirement or adjustment. The estimated costs have not been incurred to date.

This Stipulation is made this 26th day of November, 1985.

John B. Lowry  
McCutchen, Doyle, Brown &  
Enersen

By /s/ John B. Lowry  
Counsel for Plaintiff

John K. Van de Kamp,  
Attorney General of the State  
of California

Edward P. Hollingshead,  
Supervising Deputy Attorney  
General

By /s/ Derry L. Knight  
Derry L. Knight, Deputy  
Attorney General  
Counsel for Defendants

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF ILLINOIS  
EASTERN DIVISION

IMPERIAL CHEMICAL	)	No. 84-Co-8906
INDUSTRIES PLC	)	(Judge Williams)
	)	
Plaintiff,	)	
	)	SUPPLEMENTAL JOINT
v.	)	STIPULATION OF
	)	FACTS
THE FRANCHISE TAX	)	
BOARD OF THE STATE OF	)	
CALIFORNIA; operating	)	
through its Chicago office;	)	
and LEONARD WILSON,	)	
individually and as District	)	
Manager, Chicago Office of	)	
the State of California	)	

WHEREAS, subsequent to the filing of a Joint Stipulation on December 2, 1985, certain facts have occurred which the parties wish to make the subject of this Supplemental Joint Stipulation of Facts.

IT IS ACCORDINGLY STIPULATED AND AGREED by the parties through their respective counsel that:

This stipulation shall not be construed as a concession by any party of relevance and materiality of any of the facts herein recited, and the parties expressly reserve the right to argue the relevancy or materiality of any of the facts herein recited.

Exhibits attached are included by reference and may be entered into evidence as facts except as expressly provided herein.

This stipulation shall apply only in the above-entitled action and in any appeal from the judgment of this Court.

The following facts are agreed and undisputed and may be treated by the Court as facts proven in open court.

1. On November 8, 1985 the President of the United States issued a "Statement By the President" addressing the worldwide unitary method of taxation, a copy of which is attached as Exhibit 23.

2. On December 18, 1985, S. 1974 was introduced in the United States Senate by Senator Pete Wilson. The text is included in the attached Exhibit 24. At the same time a parallel bill, H. R. 3980 was introduced in the House of Representatives.

3. The text of a statement by Senator Wilson in introducing S. 1974 is included in the attached Exhibit 24.

4. A copy of a letter dated December 18, 1985, from the Secretary of the Treasury to the President of the Senate transmitting S.B. 1974 is attached as Exhibit 25. At the same time a parallel letter was sent to the Speaker of The House of Representatives.

5. The text of a statement by Congressman John J. Duncan in introducing H.R. 3980 is included in the attached Exhibit 26.

This Supplemental Joint Stipulation is made this 28th day of January, 1986.

John B. Lowry  
McCutchen, Doyle, Brown &  
Enersen

By /s/ John B. Lowry  
Counsel for Plaintiff

John K. Van de Kamp,  
Attorney General of the State  
of California

Edward P. Hollingshead,  
Supervising Deputy Attorney  
General

By /s/ Derry L. Knight  
Derry L. Knight,  
Deputy Attorney General  
Counsel for Defendants

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IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF ILLINOIS  
EASTERN DIVISION

ALCAN ALUMINIUM	)	No. 84 C 6932
LIMITED,	)	
Plaintiff,	)	STIPULATION OF FACTS,
	)	AS REVISED
v.	)	
THE FRANCHISE TAX	)	
BOARD OF THE STATE	)	
OF CALIFORNIA, operat-	)	
ing through its Chicago	)	
office; Leonard Wilson,	)	
individually, and as Dis-	)	
trict Manager, Chicago	)	
Office of the Franchise Tax	)	
Board of the State of Cali-	)	
fornia; and B. M. Rarang,	)	
individually, and as Audi-	)	
tor, Chicago Office of the	)	
Franchise Tax Board of the	)	
State of California,	)	
Defendants.	)	

IT IS STIPULATED AND AGREED by the parties through their respective counsel that:

This stipulation is expressly subject to the right of each party to introduce additional evidence by way of judicial notice.

This stipulation shall not be construed as a concession by any party of the relevance or materiality of any of the facts herein recited, and the parties expressly reserve the right to argue the relevancy or materiality of any of the facts herein recited.

Exhibits attached are included by reference and may be entered into evidence as facts except as expressly provided herein.

This stipulation shall apply only in the above-entitled action and any appeal from the judgment of this Court.

### ISSUES

For the purposes of this litigation the parties hereby stipulate that the only legal issues before this Court are whether plaintiff may properly maintain this action and whether or not the Board's application of the unitary method of accounting under Section 25101 et seq. of the California Revenue and Taxation Code, and implementing regulations, as applied to the facts in this case violated the Foreign Commerce Clause of the United States Constitution. For purposes of this litigation, Alcan is not contesting the Board's determination that the Alcan Group Companies constitute a single unitary business under the tests formulated by the California Courts and the United States Supreme Court, or that the tax assessed violated the Due Process Clauses of the United States Constitution or the California Constitution.

### FACTS

The following facts are agreed and undisputed and may be treated by the Court as facts proven in open Court:

1. For purposes of this litigation the parties have selected the income years 1971, 1977 and 1978 as being generally representative of all years and have included

data for such years in the body of the stipulation. Comparable data has been prepared for the years 1965 through 1978 and is set forth in exhibits attached to the stipulation.

2. Alcan Aluminium Limited ("Alcan") is a corporation organized and existing under the laws of Canada. Its headquarters and principal place of business are in Montreal, Quebec.

3. During the relevant period herein, Alcan and its subsidiaries ("Alcan Group Companies") engaged in all phases of the aluminum business on an international scale. The Alcan Group Companies are independent of, and operate in competition with, all other major world aluminum producers. Their operations include the mining and processing of bauxite, an aluminum-bearing ore, the conversion of bauxite into alumina, the generation of electric power for use in smelting aluminum, the smelting of aluminum alloys into semi-finished and finished products (fabrication), the production and sale of chemicals, transportation services for cartage of raw materials, metal and general cargo, and engineering services.

4. During the relevant time period, the Alcan Group Companies had bauxite holdings and smelted primary aluminum in seven countries, produced alumina in six countries, fabricated aluminum in twenty-nine countries, operated sales outlets in over one hundred different countries and maintained warehouse inventories in various international markets. At all times relevant herein, nearly one hundred subsidiaries of Alcan operated wholly outside the United States.

5. In 1971, 1977 and 1978, the Alcan Group Companies had the following sales, assets and employees:

(000's Omitted)			
1971			
	Foreign	U.S.	Total
Sales	\$ 946,816	\$434,555	\$1,381,371
Assets	1,106,741	117,155	1,223,896
Employees	57	4	61
1977			
	Foreign	U.S.	Total
Sales	\$1,989,202	\$887,009	\$2,876,211
Assets	1,327,322	132,728	1,640,050
Employees	57	4	61
1978			
	Foreign	U.S.	Total
Sales	\$2,496,478	\$1,055,872	\$3,552,350
Assets	1,503,114	135,057	1,638,171
Employees	59	4	63

6. At all times relevant herein, neither Alcan nor any of its non-United States subsidiaries had a permanent place of business in the United States.

7. Alcan Aluminum Corporation ("Alcancorp") is a corporation organized and existing under the laws of the State of Ohio. Its principal place of business is in Cleveland, Ohio.

8. At various times since 1965 the Alcan Group Companies have had a number of member companies, in addition to Alcancorp, doing business in the United States. These entities included, but are not limited to,

Alcan Sales, Inc., Alcan Metal Powders, Inc., Alcan Cable Corp., Luxfer USA, Ltd., South Pacific Aluminum and Supplies, Inc., and Hunter Douglas Research Corp. For certain of the years, some of these entities did business in California and filed separate California returns reflecting only their income and activities. The Alcan Group Companies that did business in California, the years of their operation in California, and their formal corporate relationship to AlcanCorp are shown on the charts attached as Exhibit I. The Franchise Tax Board ("Board") upon audit included such entities in the combined report of AlcanCorp. All references to AlcanCorp, hereinafter, include such entities unless otherwise specifically noted.

9. AlcanCorp, at all times relevant, engaged in the business of fabricating and selling in the United States aluminum products consisting of aluminum sheet and coil, plate, metal powders and pigments, electrical power cable, building products, primary ingot and other metal and allied industrial products. AlcanCorp, at all times relevant, has obtained a substantial portion of its metal from Alcan Company of Canada (ACOC), a member of the Alcan Group Companies. AlcanCorp, at all times relevant, has sold roughly 5 percent of its metal products to members of the Alcan Group Companies. Prior to 1985, Alcan had no primary smelter capability within the United States, but did have substantial secondary smelting capability (scrap recycling).

10. AlcanCorp conducts certain of its business operations in the State of California and is duly qualified to do business within the State of California. During the

period 1965 through 1977, AlcanCorp's operations in California consisted primarily of a large manufacturing facility in Riverside, California. The facility was purchased from the Bridgeport Brass Division of National Distiller's and Chemical Corporation in early 1965 and was, according to the seller's books and records, incurring financial losses.

11. During the years 1965 through 1978 AlcanCorp had the amounts of property, payroll and sales in California shown on Exhibit V. For the years 1971, 1977 and 1978 AlcanCorp's California property, payroll and sales were:

	1971	1977	1978
Property	34,396,671	30,564,460	30,023,025
Payroll	8,652,337	7,021,489	7,136,019
Sales	26,919,093	50,890,777	63,978,635

12. The Board is an agency of the State of California. It maintains a permanent office for the transaction of its official business within the Eastern Division of the Northern District of Illinois.

13. Leonard Wilson was formerly District Manager of the Chicago Office of the Board and maintains his regular place of business within the Eastern Division of the Northern District of Illinois.

14. B. M. Rarang is an auditor in the Chicago Office of the Board and maintains his regular place of business within the Eastern Division of the Northern District of Illinois.

15. The Board has the power and duty to administer the Bank and Corporation Tax Law of the State of California, California Government Code section 15700 et seq. and California Revenue and Taxation Code section 23001 et seq., as well as other provisions of the laws of the State of California respecting taxation ("California Tax Law"). Defendants administer the California Tax Law with respect to numerous corporations through their Chicago office.

16. The Chicago Office of the Board has audited and determined the proper level of taxation on Alcan's subsidiary, AlcanCorp, for 1976 through 1978. The Board's agents, Rarang and Wilson, had management and supervisory responsibility for that audit.

17. During the years 1965 through the present (1985), AlcanCorp has filed original and amended returns and claims for refund with the Board which have apportioned the income shown on such returns on the basis of the three factor formula provided for in the California statutes, otherwise referred to as the Uniform Division of Income for Tax Purposes Act. Attached as Exhibit II is a chart showing the manner in which AlcanCorp filed its California return(s), whether the return(s) were filed with a refund claim, and the method by which the Board assessed the tax. Attached as Exhibit III is a chart showing the amount of tax paid by AlcanCorp with respect to each such return. For the years 1965 through 1966 the Board at audit determined that AlcanCorp and Alcan Canada<sup>1</sup> operated as a single unitary business.

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<sup>1</sup> Alcan Canada is Aluminum Company of Canada, Limited, the immediate parent of AlcanCorp.

Accordingly, the Board combined the income and activities of AlcanCorp and Alcan Canada to determine the income of AlcanCorp attributable to California and issued notices of proposed assessment. AlcanCorp, while not agreeing with the Board's right to combine the activities of AlcanCorp with Alcan Canada, or Alcan Group Companies, requested that the notices of proposed assessment be modified to include the Alcan Group Companies. Attached as Exhibit IV-1 through IV-8 is the correspondence between AlcanCorp and the Board leading to this modification.

18. AlcanCorp tax returns for 1971, 1977 and 1978 were filed as attached as Exhibit VI-1 through VI-3. AlcanCorp's refund claims which cover the same years are attached as Exhibits VII-1 through VII-3.

19. The Board has audited or is in the process of auditing AlcanCorp's returns for the years 1965 through 1981. Pursuant to these audits and the resultant administrative review process arising from AlcanCorp's protest of the audit adjustments, the Board has determined that AlcanCorp is part of a single unitary business conducted by the Alcan Group Companies. As a result, the Board has calculated AlcanCorp's California tax liability through 1978 on an apportioned share of the total business income of the unitary business conducted by the Alcan Group Companies. The apportionment fraction applied to such total income was calculated by reference to the ratio of AlcanCorp's California property, payroll and sales to all of the property, payroll and sales of the unitary business conducted by the Alcan Group Companies.

20. The Board, in calculating AlcanCorp's California tax liability, applied the unitary method of accounting as required by Section 25101 et seq., California Revenue and Taxation Code. Attached hereto as Exhibits VIII, IX, and X-1 through X-2, respectively, are copies of the statutes, the current regulations adopted pursuant thereto, the filing instructions for the preparation of a combined report, and related corporation tax forms and instructions.

21. The business income subject to apportionment that was the basis for the Board's assessment was determined by the Board from information contained in consolidated financial statements for the Alcan Group Companies as reflected in Alcan's published annual reports prepared for shareholders, information contained in form "10-Ks" filed by Alcan with the United States Securities and Exchange Commission, and other information submitted by AlcanCorp which was obtained from Alcan. The consolidated financial statements contained in Alcan's annual reports were certified by an independent certified public accounting firm of Price Waterhouse and Company as fairly representing the financial position of the Alcan Group Companies in accordance with Canadian generally accepted accounting principles (GAAP). Copies of "Form 10-Ks" filed by Alcan for the years 1971, 1977 and 1978 are attached hereto as Exhibits XI-1 through XI-3, respectively. Annual reports prepared by Alcan for the years 1965, 1966, 1967, 1968, 1969, 1970, 1971, and 1980 are attached hereto as Exhibits XII-1 through XII-8, respectively.

22. For purposes of computing the income attributable to California activities, the Board began with the net

income before taxation as reflected in Alcan's annual reports and adjusted it to eliminate Alcan's equity interest in corporations 50 percent or less owned. Information for this adjustment was also set forth in the annual reports. To arrive at business income, sometimes adjustments were made to eliminate gains or losses reflected in the annual reports from the disposition of various assets which were classified as nonbusiness assets. Further adjustments were made to business income for all years to provide for the use of percentage depletion and accelerated depreciation based upon data supplied by AlcanCorp which it obtained from Alcan. Attached as Exhibit XIII is a chart showing the adjustments requested and adjustments made by the Board as described in paragraphs 20 and 21.

23. Business income has not been adjusted except as hereinabove described. For some of the years adjustments have been requested to allow for the use of the LIFO method of accounting for inventories for entities other than AlcanCorp, to eliminate equity interests of Q.A.L., Rio del Norte and Halco included in the cost of goods sold, to eliminate unrealized currency exchange gains or losses not reflected separately in the published reports to shareholders and to eliminate the income of sea transportation companies. No adjustments were made for these items by the Board either because the Board believed that the time had elapsed for making a request for such adjustments, data deemed sufficient by the Board for making such adjustments was not submitted, or because the parties disagreed as to the manner in which the adjustments should be made. The correctness of the Board's position

with respect to such requested adjustments is not conceded by AlcanCorp.

24. The procedure followed to determine the accelerated depreciation adjustment for the Alcan Group Companies (other than AlcanCorp) is set forth below:

- a) Depreciation calculated on a straight line basis was reflected in Alcan's published annual reports.

For purposes of the calculation it was assumed an average rate of book depreciation would be 5 percent.

- b) Asset additions for the year for Aluminum Company of Canada, Limited (ACOC) were obtained from the capital cost allowance schedule from its Canadian Federal tax returns. AlcanCorp's additions were taken from its U. S. Federal 1120 tax returns. Asset additions for Indian Aluminum Company and Alcan Aluminiumwerke GmbH were obtained from schedules forwarded to Alcan's tax department by the foreign subsidiaries of Alcan. The sampled additions constituted approximately 70% of the total Alcan Group Companies' acquisitions for the year.

The dispositions were obtained by AlcanCorp from Alcan's tax department in Montreal.

- c) ACOC's assets were reclassified from their Capital Cost Addition Schedule into Asset Depreciation Range (ADR) categories by the Alcan and AlcanCorp tax department personnel by comparing the written descriptions of the Canadian and U. S. tax depreciation guidelines.

- d) Mid-range ADR class lives were utilized.

- e) A weighted average effective depreciation rate was calculated, based on the foregoing information. This weighted average rate was applied to the

Alcan Group Companies' total asset additions for the year.

- f) Additional depreciation equal to the difference between the ADR allowable depreciation and straight line depreciation was allowed (after certain adjustments for recoveries on disposition).

- g) The additions from years prior to 1965 were not included in the accelerated depreciation calculation. No accelerated depreciation was computed for assets acquired prior to the year 1965.

25. AlcanCorp asserts, and the Board does not contest, that the total costs incurred by AlcanCorp in collecting the data and performing the calculations described in paragraph 24 were as follows:

i) Travel to Montreal, Quebec, the source of necessary data	\$450.00
ii) Accommodations spent in Montreal, Quebec	\$350.00
iii) Time spent in Montreal, Quebec	32 hours
iv) Time spent in U.S.	120 hours

The total costs incurred by Alcan and its non-U.S. subsidiaries are as follows:

i) Time to collect data contained outside the U.S. and Canada	800 hours
ii) Time to collect and collate data in Canada	75 hours

26. The denominators of the apportionment factors utilized by the Board were calculated as follows:

a) The denominator of the property factor was calculated by adding the total value of the Alcan Group Companies' fixed assets, valued at original cost, to the value of inventory, and deducting therefrom the value of construction in progress. All of this data was set forth in Alcan's published annual reports. In addition, rent paid by the Alcan Group Companies was capitalized at eight times and added to the owned assets. AlcanCorp supplied the amount of total rents to the Board for each year which it obtained from Alcan. The property factor has not been adjusted, nor has AlcanCorp requested any such adjustments, for

- i) Unamortized goodwill
- ii) Idle facilities
- iii) Fixed assets of shipping companies<sup>2</sup>
- iv) Assets used by the Alcan Group Companies which were government owned.

b) The denominator of payroll factor for the Alcan Group Companies was obtained by AlcanCorp from Alcan for each year and was provided to the Board. AlcanCorp has recently discovered that the data provided to the Board was based on accrued compensation including fringe benefits rather than wages and salaries. The amount of fringe benefits are unknown and unavailable, but to the extent they were included they would increase the denominator of the payroll factor, resulting in a reduction of the California payroll factor, the amount of income apportioned to California, and AlcanCorp's resultant California tax liability.

<sup>2</sup> See footnote 4, *infra*.

c) The denominator of sales factor included all sales of the Alcan Group Companies, which sales were taken from the published annual reports. This number has not been adjusted for unrealized exchange gains and losses.

27. For all years 1965 through 1978 the Board's calculation of AlcanCorp's California tax liability was based upon a determination that AlcanCorp was part of the unitary business conducted by the Alcan Group Companies. A summary of the calculation of AlcanCorp's California tax liabilities is attached as Exhibit XVIII. For the years 1971, 1977 and 1978 the calculations are as follows:

	1971	1977	1978
Alcan Group Companies' Business Income	\$52,243,637	\$286,050,938	\$453,739,456
AlcanCorp's California Apportionment Percentage	1.758%	1.1562%	1.0825%
AlcanCorp's California Business Income	918,443	3,307,321	4,911,730
Interest Offset	- - -	- - -	- - -
Income Taxable to California	918,443	3,307,321	4,911,730
Tax Rate	7%	9.0%	9.0%
Tax	64,291	297,654	442,056

28. The additional taxes determined to be due from AlcanCorp by the Board were principally due to the Board's conclusion that AlcanCorp was part of the unitary business conducted by the Alcan Group Companies, requiring the use of a combined report including the business income and factors of the unitary business.

29. AlcanCorp has paid the additional assessments and has pursued administrative remedies with the Board regarding the Board assessments for the years 1965 through 1974, and has instituted suits for refund as authorized by California law. AlcanCorp did not elect to petition the Board for relief under the provisions of California Revenue and Taxation Code section 25137. AlcanCorp contends in those actions, inter alia, as here, that inclusion in the formulary apportionment of the Alcan Group Companies foreign (to the U.S.) income and activities is violative of the U.S. constitution. Copies of AlcanCorp's state court complaints covering the years 1965 through 1971, and 1972 through 1974 are attached hereto, respectively, as Exhibits XIX-1 and XIX-2. Said actions are presently pending.

30. Income which has been properly reported for financial reporting purposes under either Canadian or United States GAAP can, with adjustments, generally be used for tax purposes.

31. Some differences between pre-tax financial income and business income subject to apportionment by California are as follows:

- a) Amortization of amounts expended for
  - i) goodwill
  - ii) trademarks and trade names

- b) Equity income
- c) Self insurance reserves
- d) Initiation fees - Country Clubs
- e) Gifts to Employees
- f) Life Insurance Premiums - Officers
- g) Foreign exchange gains and losses
- h) Non-business income
- i) Contingency reserves

In addition, adjustments to pre-tax financial income may be elected in computing business income subject to apportionment by California in the following areas:

- a) Depletion
- b) Depreciation
- c) Inventory accounting
- d) Legal fees - Acquisition
- e) Start-up expenses
- f) Organizational expenses
- g) Construction Period Interest and Taxes
- h) Software costs

The following items should be treated in an identical manner in computing pre-tax financial income and business income subject to apportionment by California.

- a) Bond issuance costs
- b) Capitalized leases

Any of these adjustments referred to in this paragraph are subject to the provisions of California Administrative Code, title 18, section 25137-6(e).

32. In preparing a combined report to compute its California income a taxpayer may, but is not required, to elect various tax accounting methods which differ from accounting methods employed for financial accounting purposes. In making such election, AlcanCorp might require the assistance of Alcan.

33. If Alcan were to calculate the accelerated depreciation, LIFO and other Schedule M item adjustments possible for the Alcan Group Companies and the denominators of the apportionment factors, Alcan would require each of its reporting entities to submit additional information to comply with methods set forth in subparagraphs A, B, and C hereof. The Board does not agree that additional information would be necessary or that the methods described in this stipulation are the exclusive means for making such adjustments or calculating the denominators of the apportionment factor. Alcan's subsidiaries maintain such records as it or its independent auditors may require in order to consolidate the accounts of the subsidiary companies with those of Alcan for financial accounting purposes in Canada and to allow management to monitor the subsidiaries' operations. In order to obtain the information in the required format, Alcan has established a uniform Chart of Accounts and provided directions to the subsidiaries for submission of the data it requires to file consolidated financial statements in accordance with Canadian generally accepted accounting principles. The subsidiaries of Alcan report their financial data to Alcan on the Uniform Financial Statements ("UFS"), attached hereto as Exhibit XIV. Some subsidiaries consolidate the data of several of their reporting entities into the data represented on the UFS.

For example, one subsidiary in England filed a consolidated UFS for 50 entities, another in Brazil included 7 entities in a single UFS, and one UFS was filed for 10 Indian companies. The subsidiaries also keep their books and records in accordance with the accounting rules of their host countries. These books and records of the subsidiaries are maintained at their various headquarters' locations throughout the world.

A. Under one possible method Alcan might elect to calculate accelerated depreciation, each reporting location around the world would be required to analyze its property, plant and equipment accounts using the asset depreciation range classes as defined for California tax purposes (identical to federal ADR classes). Each year the following analyses by asset class would have to be submitted:

- 1) additions (assets placed in service) during the year
- 2) original cost of assets retired during the year, segregated between ordinary and extraordinary retirements
- 3) proceeds of disposals of assets during the year, segregated between ordinary and extraordinary retirements

Alcan's Consolidated Accounting Department would have to summarize the information received and calculate the amount of the accelerated depreciation adjustment. Subsidiaries other than those whose records are kept in the currency in which Alcan reports for financial purposes (U.S. dollar), would have to keep a second set of records of its fixed assets in order to provide accurate information for the accelerated depreciation calculation.

B. AlcanCorp utilizes one of the several permitted procedures to compute the LIFO valuation of its inventories. If an election were made to compute LIFO inventory values for other members of the Alcan Group Companies by the AlcanCorp method, Alcan would make the calculation in either of two ways. Alcan would require each reporting location to perform the calculation and advise Alcan of the amount of the adjustment. If each subsidiary is required to recalculate its inventory using the LIFO method, it would have to reverse any market writedowns and/or inventory reserves included in its closing inventories and restate its local currency inventories according to Canadian GAAP. Alcan would summarize the information received from the subsidiaries and make the appropriate adjustments to inventories and cost of goods sold.<sup>3</sup> In addition, Alcan would have to recalculate the intercompany profit elimination using the LIFO method. Alternatively, Alcan would request specific information from each subsidiary and calculate the adjustment at the Montreal Office. If Alcan were to calculate the amount of the LIFO adjustment, each reporting location would have to submit the following information in both local currency and Alcan's currency for financial reporting purposes:

- i) closing inventory at average cost
- ii) closing inventory at average cost at preceding year end

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<sup>3</sup> There are approximately the same number of subsidiaries reporting inventories as reporting property, plant and equipment. However, as in the case of fixed assets, one subsidiary reporting to Alcan may be comprised of many separate subsidiaries.

- iii) closing inventory at earliest acquisition or produced cost

Alcan would then have to calculate the amount of the LIFO adjustment for each inventory pool and summarize to arrive at the total adjustment. Alcan would still have to recalculate the intercompany profit elimination using the LIFO method.

C. Alcan would have to undertake collections of data involving differing degrees of administrative burdens for each of the following categories of information to make adjustments to arrive at business income as defined by California.

- 1. Currency translations gains/losses.
- 2. Nonbusiness income such as rents, royalties, interests and dividends.
- 3. Shipping company income.<sup>4</sup>
- 4. Schedule M Adjustments – California's Franchise Tax starting point is a corporation's Federal taxable income before net operating loss deduction and special deductions. Therefore, Alcan would have to determine other adjustments to arrive at taxable income under the Internal Revenue Code ("Schedule M Adjustments"). This category includes timing and permanent adjustments from book to taxable income that would involve thousands of separate adjustments on a worldwide basis.

Schedule M adjustments would include but not be limited to the following:

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<sup>4</sup> The parties do not agree conceptually on how this adjustment should be made.

Depletion  
 Legal Fees - Acquisitions  
 Bond Issuance Expenses  
 Start-up Expenses  
 Software Expenditures  
 Goodwill  
 Organizational Expenditures  
 Trademarks and Tradenames  
 Construction Period Interest and Taxes  
 Equity Income  
 Contingency Reserves  
 Self-Insurance Reserves  
 Capitalized Interest  
 Capitalized Leases  
 Foreign Exchange Gains and Losses  
 Dividends  
 Initiation Fees - Country Clubs  
 Gifts to Employees  
 Life Insurance Premiums - Officers

Adjustments were allowed by the Board with respect to Depletion, Equity Income and an exchange gain (resulting from the conversion of Alcan's financial statement income for 1970 from Canadian to U.S. dollars [see para. 31] reflected in Alcan's annual reports. Whether any other Schedule M adjustments would be applicable with respect to the Alcan Group Companies or they would increase or decrease business income subject to apportionment is unknown. No Alcan Group Companies operating outside of the U.S. have the need to accumulate and process the data necessary to actually calculate LIFO, Accelerated Depreciation, other Schedule M adjustments of apportionment factors.

5. Apportionment factor data not readily obtainable such as salaries and wages and rental expense.

34. The methods described by Alcan are not the only methods for calculating these adjustments. The

Board has accepted alternative methods and in this case has accepted a different method for calculating accelerated depreciation as detailed in paragraph 22. The practice of the Board, with respect to such adjustments, is set forth in Exhibit XV.

35. If it be assumed that Alcan must do all of the acts detailed in paragraph 33 and in Exhibit XVI, then said Exhibit XVI contains a reasonable estimate of costs for doing so. The Board does not concede that Alcan must do the acts so detailed. None of these costs, other than those described in paragraph 25, have been incurred.

36. Data necessary to make the adjustments described in 33 would also be required of any U.S. corporation with foreign activities which made such adjustments.

37. Alcan stock is traded publicly in the United States. Foreign companies whose stock is traded on a national exchange are required to register with the Securities and Exchange Commission and thereafter to file yearly information statements. For financial reporting purposes both the initial and the yearly statements may be expressed in accord with the generally accepted accounting practices (GAAP) of the country of corporate domicile. However, in such cases a reconciliation of the foreign to U.S. GAAP is required.

38. Beginning in 1970 the consolidated financial statements in Alcan's annual reports were prepared in United States dollars. For years prior to 1970 the consolidated financial statements were prepared in Canadian Dollars. Alcan's reason for changing to United States dollars was explained in its Form 10-K filed with the U.S.

Securities and Exchange Commission for the fiscal year ending December 31, 1970. (See Exhibit XVII hereto.)

39. Set forth below in columns B and C, respectively, is the Alcan Group Companies' preapportioned income for financial reporting purposes in U.S. dollars and the Alcan Group Companies' business income used by the Board to determine AlcanCorp's franchise tax. Also shown in column D is AlcanCorp's U.S. federal taxable income or loss. AlcanCorp's taxable income for United States federal income tax purposes was calculated on the basis of its separate books and records, excluding Luxfer.

(000's omitted)  
ALCAN GROUP COMPANIES\*

		ALCANCORP	
(A)	(B)	(C)	(D)
Year	Worldwide Financial Pre-Tax Income Per Annual Report	Worldwide Pre-Tax Income Determined By Board	Federal Taxable Income (Loss)
1965	Can.\$ 128,908	\$105,754	(\$ 2,847)
1966	Can.\$ 144,679	115,587	( 1,923)
1967	Can.\$ 117,174	85,452	( 4,283)
1968	Can.\$ 138,807	92,935	( 3,926)
1969	Can.\$ 164,122	108,607	( 9,917)
1970	128,971	68,962	( 3,204)
1971	102,758	52,243	( 141)
1972	79,420	37,789	3,706
1973	109,936	67,428	1,614
1974	224,517	178,456	12,839
1975	69,315	NOT AUDITED	( 6,746)
1976	96,398	48,827	9,250
1977	336,768	286,051	( 241)
1978	497,521	453,739	61,399

\* All amounts are in United States dollars unless otherwise noted.

40. The income for the Alcan Group Companies as set forth in column B of paragraph 39 has been determined under Canadian Generally Accepted Accounting Principles ("GAAP").

41. The difference between Alcan Group Companies' pre-tax financial income per annual report (column B above) and the business income subject to apportionment determined by the Board (column C above) set forth in paragraph 39 results from deductions for the following factors:

Adjustment for Percentage Depletion<sup>5</sup>  
Deduction for Accelerated Depreciation  
Conversion from Canadian Dollars into U.S.  
Dollars<sup>6</sup>  
Elimination of Equity Income  
Deduction for Nonbusiness Income  
Schedule M Adjustments for AlcanCorp

42. The income for the Alcan Group Companies, as reported in published financial statements, was derived from the results of the individual member corporations of the Alcan Group Companies. Alcan represents and the Board does not contest that the pre-tax income of the individual companies reflected on their separate books and records adjusted to Canadian GAP and the income and withholding taxes paid to each entity's host jurisdiction are as set forth below:

<sup>5</sup> See paragraph 24.

<sup>6</sup> For the years 1965-1969, Alcan presented its consolidated financial statements in Canadian dollars. The Board translated these amounts into U.S. dollars.

1971  
(in thousands of U.S. Dollars)

<i>Company Name</i>	<i>Pretax Income Calculated from Separate Books And Records Before Adjust- ments*</i>	<i>Income and Withholding Taxes Paid to Host Jurisdictions*</i>
<i>U.S.A.</i>		
Alcancorp	(2551)	(75)
Aluminium Limited, Inc.	(23)	-
<i>Canada</i>		
Alcan	(1868)	1362
Alcan Building Products	(247)	25
ADH	1465	(170)
Fiduciaries	119	43
Alfin	208	
Alatina	(395)	
Alingot	575	
Alcanint	164	50
Alcanore	124	
Alcanpipe	29	
Alcan R&D	(289)	107
Secretariat	47	
Alships	107	54
A&J	269	137
Alsco Group	297	232
ACOC	18083	5836
Algoods	(103)	

\* A negative figure in column 1 an operating loss for the company.

A negative amount in column 2 indicates an overpayment of current or prior year's taxes.

Canfoils	4537	
Chagterms	485	255
Dusco	7	
Essex	(229)	
Magcan	167	85
Morfoils	(6)	
R&S	47	
Sagpower	2987	1562
Sagships	3516	1472
Sagterms	(23)	90
Sagtrans	1654	799
Seaba	1089	431
Westpro	-	
Alcanaf	-	
Alservices	(1)	
<i>Europe</i>		
Alcanital	(1392)	
Alcan Geneva	717	95
Alraeren	1314	423
Alcan: London	(6408)	
Alcan Booth	(8626)	
Alcaneur	(359)	
Alfino	(72)	
Alcanfolien	373	28
Almet	9111	
Alcansa	1100	260
Alcan-Schwartz	210	22
Alcanuk	7401	(268)
Alcanfran	463	237
Alcanwerke	(8615)	0
Aluminord A/S	(1143)	
Alcanac	(1703)	100
A/S Kinservik	251	
Le Mesnil S.A.	18	
Sagships UK	158	53
Sabap	755	374
Rorschach	1299	256

*Latin-America*

Albralam	(7)	
Aluruguay	146	
Alcanbrasil	4041	549
Almexsa	1357	518
Alcanmex	1	
Alcanven	365	86
Alcancali	451	202
Nordeste	(285)	
Aluminas	4544	388
Alucaldas	(13)	
Bauxita	2	
Fluorita	-	
MRN	(18)	
Rio Preto	(1)	0
Saref	10	
Alempree	(2)	

*Africa*

Acosa	303)	103
Alcansaf	2565	906
Alupak	(1)	
Flag	303	
Ghanal	11	77
Ind. Housing	8	
Ralco	306	
Ralco Properties	11	

*Caribbean*

Alcan Bermuda	1525	66
Aljam	13435	3711
Alprojam	44	
Demba	2539	2476
Sprostons: Jamaica	1274	404
Sprostons: Guyana	459	316
Sprostons: Trinidad	100	33

*East Pacific*

Alimasia	3	
Alcanasia H.K.	2325	1452

Alcanmalay	349	
Alcansea	165	34
Indal	11563	2596
Jomis	628	334

*South Pacific*

Alcanaust	3650	
Alzealand	1890	939
Alqueen	5405	2485
Alucon	74	45
Alfoils	50	
Austaluco	(507)	
Austrabaux	109	49
Breit	5	35
Gunnensen	(9)	
Kawneer	(74)	
Others	153	36

<i>Cumulative Sub-Total</i>	84345	31715
<i>Consolidating</i>		
<i>Adjustments</i>	8715	6606
	93060	

*Plus:*

Equity Income of  
companies owned  
20-50%

9698	-
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Pre-Tax Income Per  
Financial Statements 102758

Total Current Income Tax  
Provision and Withholding  
Taxes paid

38,321

1977  
(in thousands of U.S. Dollars)

<i>Company Name</i>	<i>Pretax Income Calculated from Separate Books And Records Before Adjust- ments</i>	<i>Income and Withholding Taxes Paid Host Juris- dictions</i>
<i>U.S.A.</i>		
Alcancorp		
Consolidated	6899	1070
Luxfer (U.S.A.)	1179	502
<i>Canada</i>		
ADH	(134)	(17)
Airmaster	(33)	7
Alafrique	7	7
Alamo	96	9
Alcan	(4926)	5824
ACOC	133583	(130)
Alcan Project	14	7
Alcanint	677	270
Alcan R&D	(405)	8
Alcantrade	88	83
Allabs	(92)	58
Alpac	711	731
Alsco (1974) Inc.	(13)	
Alsco Maritimes	(3)	
Alservices	(14)	7
Alships	304	151
Chagterms	328	184
Fiduciaries	93	55
Revalex	111	92
Alcanasp	(53)	
R&S	547	
Sagships	3931	1854
Seaba	(61)	(88)
Truseal	(33)	
Venchem	1640	

*Europe*

Aesuk	11	(53)
Alcanac	9172	3048
Alcan Booth		
Consolidated	4362	
Alcaneur	6829	1252
Alcanfolien	708	(3)
Alcanfran	818	5
Alcan: Geneva	1566	
Alcan Ireland	113	
Alcanital	(493)	66
Alcan: London	1128	32
Alcansa	1121	152
Alcan-Schwartz	226	109
Alcanuk	35291	2355
Alcanwerke	4953	8564
Alfino	1795	12
Almaneur	(3)	
Almet	7783	
Alraeren	1005	359
Folien: Berlin	(19)	
Lamal	207	46
Luxfer (U.K.)	1083	16
Nuernberg	4063	
Rorschach	3930	336
Sabap	1332	592
Sagships: U.K.	124	50

*Latin America*

Alatina Consolidated	57519	12681
Alcancali	1224	791
Alcanven	285	615
Almexsa	4601	3019
Aluruguay	1584	487
Fluorita	275	

*Africa*

Alcanigeria	2686	1289
Flag	2265	1028
Ghanal	2085	1080

Holdings	20	12
<i>Caribbean</i>		
Alcan Bermuda	3225	
Aljam	2905	87
Alprojam	149	234
Champlain	2112	69
Sprostons: Jamaica	(694)	62
Sprostons: Guyana	302	111
Sprostons: Trinidad	134	67
<i>East Pacific</i>		
Alcanasia H.K.	1985	433
Alcando	1224	
Alcansea	(7)	
Alcanthai	1213	447
Indal	13244	8239
Jomis	2333	1179
<i>South Pacific</i>		
Alcanaust	11086	5049
Alqueen	7712	727
Alzealand	2838	1000
Austrabaux	128	62
Australuco	(121)	30
Breit	(22)	(11)
Gunnerson	1	4
Kawneer	34	20
Quintrex	251	16
Cumulative Sub-Total	354132	66,485
Less:		
Consolidating Adjustments	19310	(11,871)
Plus:		
Equity Income of Companies 20-50% owned included in cost of goods sold	1946	-

Pre-Tax Income Per Financial Statement	<u>336768</u>
Total Current Income Tax Provisions and Withholding Taxes Paid	<u>54,614</u>

1978  
(in thousands of U.S. Dollars)

Company Name	Pretax Income Calculated from Separate Books And Records Before Adjustments	Income and Withholding Taxes Paid Host Jurisdictions
<i>U.S.A.</i>		
Alcancorp Consolidated	62388	29116
Luxfer (U.S.A.)	2475	1339
<i>Canada</i>		
ADH	(116)	(11)
Adminco	5	3
Airmaster	132	
Alafrique	22	22
Alamo	90	47
Alcan	768	5923
Alcanasp	(5)	
Alcan: Canada (ACOC)	217349	17409
Alcan Project	12	6
Alcanint	1052	747
Alcan R&D	(49)	8
Alcantrade	809	409
Allabs	353	175
Alpac	1173	610
AlSCO (1974) Inc.	(12)	
AlSCO Maritimes	40	
Alservices	(5)	1
Alships	166	87

Chagterms	85	43
Fiduciaries	64	47
Revalex	(175)	(40)
R&S	1236	464
Sagships	5563	2798
Seaba	262	5
Tple Victoria	(40)	
Truseal	205	
Venchem	1587	
Vic Metal	335	25
<i>Europe</i>		
Alcana	5931	1842
Alcaneur	(7324)	1453
Alcanfolien	735	
Alcanfran	3016	942
Alcan: Geneva	2049	172
Alcan Ireland	(1746)	24
Alcanital	212	75
Alcan: London (merged)	42164	(1670)
Alcansa	(1915)	
Alcanwerke	19238	9433
Alfilage	406	193
Alfino	(1754)	12
Almet	5972	(4)
Alraeren	1263	
Folien: Berlin	210	
Nurenberg	3321	
Rorschach	6177	559
Sabap	854	205
Saguenay U.K.	203	47
Technal	596	434
<i>Latin America</i>		
Alatina Consolidated	49033	10418
Alcanmex	21	6
Almexsa	6435	3417
Aluruguay	1906	405
Alcanigeria	2539	1083
Flag	469	311

Ghanal	627	378
Holdings	(899)	(9)
<i>Caribbean</i>		
Alcan Bermuda	2202	
Alcantrade: Bermuda	(34)	
Aljam	13066	85
Alprojam	71	225
Champlain	3415	89
Sprostons: Jamaica	153	369
Sprostons: Guyana	311	49
Sprostons: Trinidad	444	223
<i>East Pacific</i>		
Alcanasia H.K.	4335	715
Alcanindo	341	(13)
Alcanthai	1014	382
Alimeast	299	
Indal	20224	4433
Jomis	2011	966
<i>South Pacific</i>		
Alcanaust	16110	5792
Alqueen	9967	4706
Alzealand	3683	1365
Australaux	27	9
Australuco	60	45
Breit	(3)	5
Fabricators	77	110
Gunnerson	6	6
Quintrex	(10)	-
Cumulative Sub-Total	513277	108520
Less:		
Consolidating Adjustments	(19052)	(3591)
Plus:		
Equity Income of Companies 20-50%		

owned included in cost of goods sold	<u>3296</u>	-
Pre-Tax Income Per Financial Statement	<u>497521</u>	
Total Current Income Tax Provisions and Withholding Taxes Paid		<u>104929</u>

43. The Alcan Group Companies' current income tax provision (excluding provisions for deferred taxes) for Canadian, other foreign taxes (including withholding taxes) and United States taxes was as follows:

U.S. DOLLARS				
Year	Canadian Income Tax	Other Foreign Income Tax	United States Income Tax	Total
1965	33,599	20,887	\$ *	\$ 54,486
1966	24,358	28,137	(2,159)	50,336
1967	20,283	20,109	*	40,392
1968	39,117	24,122	(2,645)	60,594
1969	40,713	29,779	(2,562)	67,930
1970	18,767	31,734	200	50,701
1971	11,739	26,657	( 75)	38,321
1972	2,617	29,151	489	32,257
1973	7,611	42,404	205	50,220
1974	5,514	43,619	3,927	53,060
1975	5,970	23,010	(2,379)	26,601
1976	(3,135)	59,584	3,630	60,079
1977	(9,681)	62,723	1,572	54,614
1978	19,047	55,427	30,455	104,929

\* For years 1965 and 1967, the United States Tax Provision is included in the Other Foreign Income Tax Provision.

44. Prior to 1972 Canada included in income for income tax purposes all dividends but allowed a deduction for dividends from foreign subsidiaries where more than 25% of the voting shares were owned directly by the Canadian taxpayer. After 1971, dividends from foreign subsidiaries are deductible to the extent the dividends were from qualified earnings and a tax treaty between Canada and the country of residence of the payer was in force. A deduction for foreign taxes paid was allowed by Canada after 1971 in respect of dividends not entitled to a deduction per se.

45. Attached as Exhibit XX is a chart showing Federal taxable income, California taxable income, and taxable income (post apportioned income) by the other states taxing AlcanCorp for the years 1971, 1977 and 1978.

46. In computing AlcanCorp's California income under the unitary apportionment method of accounting all of the business income and all of the apportionment factors of more than 50 percent but less than wholly owned companies are included. It is unknown whether including such companies in the worldwide unitary apportionment increases or decreases the amount of income assigned to AlcanCorp's operations and activities in California.

47. The acquisition of the Riverside plant increased AlcanCorp's absolute and comparative presence in California as reflected by the three apportionment factors. As a result of this increase, a greater portion of the results of the unitary business of which AlcanCorp is a member were assigned to California.

48. In the years 1971 and 1977 the separate books and records maintained by AlcanCorp reflected losses of \$3,482,952 and \$478,429, respectively, for the Riverside facility. The income of the unitary group attributed to California due to the factors associated with the Riverside operation was \$956,866 and \$154,754, respectively.

49. During Alcan's operation of the Riverside Plant the factors of the plant increased the unitary business's income attributable to California by approximately \$15,000,000. During the same period the separate books and records maintained by AlcanCorp reflected a loss of \$5,000,000.

50. Pursuant to a consent order with the Justice Department, AlcanCorp was obligated to sell the Riverside Plant but was unable to do so. The facility was dismantled and closed down by AlcanCorp in 1977. Management's rationale for closing the Riverside facility is contained in the Request for Authorization attached hereto as Exhibit XXI.

51. Some significant accounting changes which have taken place are:

#### CANADIAN

- 1970 Prior to 1970 Alcan presented its consolidated financial statements in Canadian dollars. Beginning in 1970, Alcan's accounts have been translated into United States dollars. The U.S. dollar is the principal currency of international trade and of the Alcan Group Companies' business.
- 1979 A recommendation of the Canadian Institute of Chartered Accountants (CICA) Section 1650 (basically similar to FAS 8) changed the method

of translating long-term monetary assets and liabilities into U.S. dollars. Unrealized exchange gains and losses were deferred and amortized over the remaining lives of the related items. (Recommendation was suspended in 1983.)

- 1980 FAS 34 - capitalization of interest payments. In 1980 companies commenced capitalizing instead of expensing the interest costs associated with the financing of projects under construction.
- 1983 CICA section 1650 (similar to FAS 52) changed the method of translating into U.S. dollars the financial statements of foreign subsidiaries with self-sustaining operations.
- 1984 Canadian institute section 3805 introduced new rules regarding the treatment of investment tax credits.

#### UNITED STATES

- 1976 FAS 5 - Relating to the reporting of foreign currency gains or losses adopted.
- 1977 FAS 13 - Capitalization of leases. Previously all lease payments were charged against profits in the year of payment.
- 1983 FAS 52 changed the method of translating accounts into U.S. dollars.

52. All taxes assessed or proposed to be assessed by the Board were against AlcanCorp. The Board has not sent assessment notices to Alcan or any of the Alcan Group Companies which is not doing business in California. The Board has not directed any correspondence to Alcan or any of the Alcan Group Companies which is not doing business in California.

IT IS SO STIPULATED.

DATED: Jan. 27, 1986 By /s/ Lawrence A. Salibra, II  
LAWRENCE A. SALIBRA, II  
Counsel for Plaintiff

JOHN K. VAN DE KAMP  
Attorney General

EDWARD D.  
HOLLINGSHEAD,  
Supervising  
Deputy Attorney General

DATED: Jan. 16, 1986 By /s/ Derry L. Knight  
DERRY L. KNIGHT  
Deputy Attorney General  
Counsel for Defendants

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UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF ILLINOIS

ALCAN ALUMINIUM LIM- )	
ITED; IMPERIAL CHEMICAL )	No. 84 C 6932
INDUSTRIES, PLC )	
Plaintiffs, )	MOTION FOR SUM-
v. )	MARY JUDGMENT OF
THE FRANCHISE TAX )	ALCAN ALUMINIUM
BOARD OF THE STATE OF )	LIMITED
CALIFORNIA, operating )	
through its Chicago Office; )	
LEONARD WILSON, Indi- )	
vidually and as District Man- )	
ager, Chicago Office of the )	
Franchise Tax Board of the )	
State of California; and B.M. )	
RARANG, individually and )	
as Auditor, Chicago Office of )	
the Franchise Tax Board of )	
the State of California, )	
Defendants. )	

Now comes plaintiff Alcan Aluminium Limited and moves for summary judgment in this action pursuant to Rule 56 of the Federal Rules of Civil Procedure. The reasons supporting this motion are found in the Memorandum in Support filed concurrently with this motion and incorporated by reference herein.

Respectfully submitted,

LAWRENCE A. SALIBRA, II  
PETER D. MILLER

By /s/ Lawrence A. Salibra, II (PDM)  
By /s/ Peter D. Miller

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Law School  
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IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF ILLINOIS  
EASTERN DIVISION

IMPERIAL CHEMICAL	)	
INDUSTRIES PLC,	)	
	)	No. 84-C-8906
Plaintiff,	)	(Judge Williams)
	)	
v.	)	
FRANCHISE TAX BOARD	)	
OF THE STATE OF CALI-	)	
FORNIA, et al.,	)	
	)	
Defendants.	)	

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*PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT*

Pursuant to Rule 56 of the Federal Rules of Civil Procedure, Plaintiff, Imperial Chemical Industries PLC ("ICI"), moves for summary judgment on all issues raised in its Complaint filed on October 15, 1984. The ground for this Motion, which will be fully discussed in the Memorandum in Support of Plaintiff's Motion for Summary Judgment, is that the imposition by Defendants of "worldwide unitary income taxation" upon Plaintiff and its subsidiaries is prohibited by the Constitution of the United States.

WHEREFORE, ICI respectfully requests the Court to rule that the imposition by Defendants of "worldwide unitary income taxation" upon Plaintiff and its subsidiaries is prohibited by the Constitution of the United States. On the basis of this ruling, and the applicable law, ICI requests that the Court enter Summary Judgment for ICI and against Defendants on all issues raised in ICI's

Complaint, and, permanently enjoin Defendants from assessing, levying or collecting any tax, the amount of which is determined, in whole or in part, by reference to the worldwide income of Plaintiff and its subsidiaries.

Dated this 31st day of January, 1986.

Respectfully submitted,

/s/ James Merle Carter  
One of the Attorneys for  
Imperial Chemical Industries PLC

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UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF ILLINOIS  
EASTERN DIVISION

IMPERIAL CHEMICAL	)	
INDUSTRIES PLC,	)	
Plaintiff,	)	
v.	)	No. 84-C-8906
	)	(Judge Williams)
FRANCHISE TAX BOARD	)	
OF THE STATE OF CALI-	)	
FORNIA, operating	)	
through their Chicago	)	
office; and LEONARD	)	
WILSON individually and	)	
as District Manager, Chi-	)	
cago Office of the State of	)	
California,	)	
Defendants.	)	

SUMMARY STATEMENT OF STIPULATED FACTS

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### SUMMARY STATEMENT OF STIPULATED FACTS

Plaintiff Imperial Chemical Industries PLC ("ICI") submits this Summary Statement of Stipulated Facts that, together with the Joint Stipulation of Facts and Supplemental Joint Stipulation of Facts filed in this case, constitute the statement of material facts required by Local Rule 12(e).

All of the facts in this case have been stipulated by the parties or are subject to judicial notice. References herein to the Stipulation of Facts and attached exhibits, filed December 2, 1985, are to "Stip. ¶ \_\_\_\_" and "Stip. Ex. \_\_\_\_". Similar references to the Supplemental Stipulation of Facts filed January 31, 1986, are to "Supp. Stip. ¶ \_\_\_\_" and "Supp. Stip. Ex. \_\_\_\_".

#### A. ICI and Its Subsidiaries

1. ICI is an English public limited company having its principal offices and place of business in London, England. ICI is widely held, having approximately 350,000 shareholders owning stock with an equity value of about 3,800 million pounds sterling. ICI's stock is traded on the London Stock Exchange. Stip. ¶ 2.

2. ICI does not do business in California or elsewhere in the United States. ICI is not subject to the California Bank and Corporation Tax Law. Stip. ¶ 1.

3. ICI has about 400 subsidiaries (over 50% ownership) and about 100 "associated companies" (between 20% and 50% ownership). Stip. ¶ 4; Stip. Ex. 3. ICI Americas Inc. ("Americas") is the principal operating subsidiary of ICI in the United States. Americas is a Delaware corporation that does business in California

and is subject to the Franchise Tax imposed by the California Bank and Corporation Tax Law. Stip. ¶¶ 5 and 6. As used herein the "ICI Group" means ICI and its over 50% owned subsidiaries.

4. Americas is a wholly owned subsidiary of American Holdings Inc. ("Holdings"), itself a wholly owned subsidiary of ICI. Holdings is a Delaware corporation that has never conducted business in California. The sole activity of Holdings is holding stock in subsidiary corporations. Stip. ¶ 6.

5. The business activities of the ICI Group comprise thirteen diverse principal business groupings with a broad range of product lines, e.g., fertilizers, paints, pharmaceutical drugs and crude oil. The main business groupings are: Agricultural; Agrochemicals and Colours; Fibres; General Chemicals; Industrial Explosives; Oil; Organics; Paint; Petrochemicals and Plastics; Pharmaceuticals; Polyurethanes; Plant Protection; and Specialty Chemicals and Materials. Stip. ¶ 3.

6. ICI owns, directly or indirectly, 50% or more of principal manufacturing subsidiaries in the following nations in addition to the United Kingdom: Canada; Argentina; United States; Malaysia; Australia; Japan; New Zealand; Pakistan; and India. Stip. ¶ 4.

7. In 1984, the ICI Group reported gross sales worldwide, eliminating intercompany trading, of 9,909 million pounds sterling. Of this amount, 6,774 million pounds was derived from sales in nations other than the United Kingdom. Gross sales in the United States for the

same year by Americas and its subsidiaries were approximately 12.5% of the worldwide total. All of the Americas' income is taxable for federal income tax purposes and is classified as United States source income under the Internal Revenue Code. Stip. ¶ 5.

8. In July 1971, the stock of Atlas Chemical Industries, Inc., an unrelated Delaware corporation, was acquired by Americas. Atlas was liquidated on September 30, 1971, and Americas thereupon became the parent of a number of Atlas foreign subsidiaries. By September 30, 1975, all of the foreign subsidiaries had been liquidated or sold by Americas to ICI or third parties. Americas has not had foreign subsidiaries since 1975. Americas has not had foreign operations since 1975 except for a limited amount of export sales to foreign countries. Stip. ¶ 7.

9. Since 1971 Americas has conducted business in California principally through operation of a pharmaceutical manufacturing plant in Pasadena as well as other sales and manufacturing activities. Stip. ¶¶ 6 and 8. Americas conducts activities in California at the present time at four separate facilities, with a total of approximately 506 employees. A related company has 71 employees in California. Stip. ¶ 8.

#### B. *The Board's Unitary Tax Determinations*

10. Defendant, Franchise Tax Board of the State of California ("Board"), is an official agency of the State. The Board's responsibilities include administration, collection and enforcement of the state's corporate income and franchise taxes. Stip. ¶ 9.

11. The unitary apportionment formula used by the Board is a method of determining the amount of income of a taxpayer attributable to and taxable by California. Under this method, all business activities that are deemed to function as a "unitary" business are combined. The combined income is apportioned by a formula that compares activities conducted in California to the activities of the "unitary" business everywhere. Stip. ¶ 15. This requires three steps:

(a) Identification of all activities that constitute a "unitary" business.

(b) Determination of the business income and elimination of all nonbusiness income of the "unitary" business. Nonbusiness income is income that does not arise from the conduct of the "unitary" business (e.g., certain investment income).

(c) Apportionment by formula of the business income of the "unitary" business. The apportionment formula is the average of the ratios of property, payroll and sales of the "unitary" business in California to the property, payroll and sales of the "unitary" business everywhere. Stip. ¶ 15.

12. For income years 1972 through 1981, Americas filed California franchise tax returns. For those years in which Americas reported net income, apportionment to California was made on the basis of the three-factor formula, using California property, California payroll and California sales of Americas as the numerators and all property, all payroll and all sales of Americas as the denominators. Stip. ¶ 10.

13. Americas' taxes payable to California, net of credits, for the income years 1972 through 1981 were reported as follows (dollars) (Stip. ¶ 12):

Income Year Ended	Business Income Loss	Apport. Factor (%)	Calif. Business Income	Tax Rate (%)	Tax
9/30/72	\$(6,819,633)	-	-	min.	\$100
9/30/73	(27,434,974)	-	-	min.	200
9/30/74	19,540,882	3.9248	\$699,722	9.0	62,975
9/30/75	10,974,668	4.4176	484,455	9.0	43,600
12/31/75	(2,038,420)	5.1430	-	min.	200
12/31/76	17,393,771	5.2894	920,010	9.0	82,801
12/31/77	25,926,761	5.0830	1,315,564	9.0	118,401
12/31/78	41,416,104	5.2357	2,166,422	9.0	194,978
12/31/79	2,795,678	5.0342	147,640	9.0	13,287
12/31/80	6,021,966	5.1912	311,757	9.0	28,058
12/31/81	17,475,583	4.9449	869,057	9.6	83,429

14. For income years ending 1972 through 1981, the Board conducted audits of the California franchise tax returns of Americas. The auditors demanded information from Americas personnel relating to consolidating entries of ICI; intercompany transactions of ICI and its worldwide subsidiaries; data on worldwide rentals; worldwide property detail; worldwide construction in progress; worldwide payroll detail; and worldwide sales of ICI and all of its subsidiaries. The auditors also sought information on worldwide research facilities and expenditures of ICI and its subsidiaries. The auditors requested "a breakdown of the California inventory and property at original cost in historical English pounds." Stip. Ex. 12, p. 2 (emphasis added). Americas personnel supplied all information within their possession but requested the Board to contact the London office of ICI for worldwide information.

15. The Board determined that Americas was part of a single, worldwide, unitary enterprise conducted by all members of the ICI Group. Stip. ¶ 13. Based upon this determination, the Board recomputed business income subject to California tax by applying the three factor apportionment using as the apportionment base the assumed worldwide income of the ICI Group. Stip. ¶ 14.

16. The Board's redetermination of Americas' California tax liabilities (disregarding an undisputed credit) for the income years 1972 through 1981, were as follows (in dollars) (Stip. ¶ 19):

Income Year Ended	ICI Worldwide Business Income*	Cal. Apport. Factor(%)	Cal. Bus. Income (\$)	Tax Rate (%)	Rede- termined Tax (\$)
9/30/72	300,945,155	.3254	979,276	7.45	72,956
9/30/73	559,403,136	.2540	1,420,884	7.95	112,960
9/30/74	892,835,033	.2335	2,084,770	9.0	187,629
9/30/75	751,667,365	.2825	2,123,460	9.0	191,111
12/31/75	168,943,576	.2763	466,791	9.0	42,011
12/31/76	892,094,114	.2922	2,606,699	9.0	234,603
12/31/77	853,140,345	.3128	2,668,623	9.0	240,176
12/31/78	878,282,236	.3738	3,283,019	9.0	295,472
12/31/79	1,255,194,918	.3463	4,346,740	9.0	391,206
12/31/80	604,695,081	.3273	1,979,167	9.6	190,000
12/31/81	265,511,942	.3475	922,654	9.6	88,575

\* For convenience of the Court, this table shows ICI worldwide business income in U.S. dollars. The actual computations were done by the Board in pounds sterling, with the amount of income apportioned to California also computed in pounds sterling, which was then converted to U.S. dollars for purposes of computing the California tax. Stip. ¶ 19.

17. The increases in Americas' California tax liability resulted almost entirely from the determination by the Board that Americas was part of a "unitary" business conducted by the ICI Group and that use of worldwide formulary apportionment was required to determine properly the ICI Group's California taxable income. Insubstantial adjustments were also made increasing California sales over the amounts reported by Americas. These adjustments had little effect on the amount of tax redetermined. Stip. ¶ 20.

18. After issuance by the Board of Notices of Proposed Assessment and the filing by Americas of a protest, the Board made a small (7%) reduction in the redetermined taxes for the years 1976-1981 by excluding from apportionable income United Kingdom investment grants to ICI. Stip. ¶ 19.

19. In computing the ICI Group's income apportionable to California, the Board began with the consolidated income of the ICI Group shown in the financial statements contained in ICI's published annual reports, expressed in pounds sterling. Adjustments based on information contained in the published annual reports were made by the Board purporting to eliminate exchange rate gains and losses and the earnings of corporations owned 50 percent or less by ICI. Adjustments were also made by the Board to the earnings of ICI purporting to conform the statements to California tax accounting. The Board eliminated nonbusiness income for 1971-1975. For 1976-1980, however, dividends from 50% or less owned subsidiaries of ICI were included as business income. Stip. ¶ 21.

20. The numerators of the factor fractions of the apportionment formula were supplied to the Board by Americas, with adjustments made to reflect sales assigned to California. These amounts were converted by the Board to pounds sterling, using average exchange rates for the year as published by the International Monetary Fund. Stip. ¶ 22.

21. The denominators of the factor fractions of the apportionment formula were derived by the Board from the published financial statements of the ICI Group in ICI's annual reports that are expressed in pounds sterling. Fixed assets (land, plant and equipment) are shown on a consolidated basis in the annual reports, either at original cost or on a revalued basis. If assets are revalued, any changes are reflected in a revaluation reserve that is also shown. Stip. ¶ 23.

22. The inventory of the ICI Group is stated in the annual reports. Because ICI Group rents were not available to be included in the denominator of the property factor, the Board eliminated rentals from both the numerators and denominators of the property factors. ICI Group payroll and sales were taken directly from ICI's published annual reports. Stip. ¶ 23.

23. The California apportionment factor was calculated by averaging the three-factor fractions. The numerator and denominator of each of the fractions was expressed in pounds sterling. The apportionment factor was then applied to the worldwide business income of the ICI Group (as derived from the annual reports of ICI expressed in pounds sterling). The result, business income apportioned to California, was translated into

dollars at the average exchange rates for the year published by the International Monetary Fund and the California tax was then calculated by applying the current rate to such apportioned income. Stip. ¶ 24.

24. Americas paid the additional assessments for 1972-1975 and timely filed claims for refund with the Board. The refund claims contested the Board's assertion that the ICI group conducted a "unitary" business in California. Americas also filed a protest of the proposed assessment, calculated on the same finding, for the years 1976 through 1981. Americas believes that increased assessments for years after 1981, including 1983, a loss year for Americas, are likely to be proposed by the Board on the same unitary basis as earlier years. Stip. ¶ 29.

#### *C. The Board's Information Requests*

25. In its audits of Americas, the Board requested Americas to provide extensive accounting data and financial information relating to ICI and other members of the ICI Group. Stip. ¶ 26; Stip. Ex. 8, 9, 11 and 12. Except for information involving Americas transactions and matters published in the ICI annual reports, the requested ICI Group information was not in the possession of Americas. The remaining information was available, if at all, only from ICI. Much of the information requested was not readily available from any source and is outside the scope of ICI's accounting records. Stip. ¶¶ 26 and 31; Stip. Ex. 9.

26. ICI collects and maintains data on the property, payroll and sales of its subsidiaries in a summary form. Detailed supporting data is maintained only at the

subsidiary level. Summary data is collected, aggregated and submitted by the subsidiaries on annual "T" Forms. These "T" Forms are used by the various worldwide subsidiaries of ICI to report annual financial results to ICI in London. The "T" Forms are balance sheets and profit and loss statements conformed to United Kingdom accounting standards, with data that are not necessarily stated at calendar year ends, but at dates determined by the statutory accounting year of the subsidiary. The "T Form" is the only standard financial report submitted regularly to ICI by its worldwide subsidiaries. Stip. ¶ 31.

27. American Depositary Receipts issued by Morgan Guaranty Bank, each representing four ordinary shares of ICI stock, are traded on the New York Stock Exchange. Stip. ¶ 2. ICI files an annual Form 20-F with the Securities and Exchange Commission in respect of the American Depositary Receipts listed on the New York Stock Exchange and certain publicly issued debentures. Notes to the financial statements in these Forms summarize material adjustments to net income and stockholder's equity that will be required if United States Generally Accepted Accounting Principles ("GAAP") were applied instead of United Kingdom principles. For the years shown below, these required adjustments to income are (in pounds sterling):

	1982	1983	1984
U.S. GAAP	157,000,000	286,000,000	614,000,000
U.K. GAAP	<u>145,000,000</u>	<u>378,000,000</u>	<u>585,000,000</u>
Required Adjustment	<u>(12,000,000)</u>	<u>92,000,000</u>	<u>(29,000,000)</u>

The Form 20 does not attempt to reconcile accounting differences between United States GAAP and accounting principles of host nations of ICI's overseas (non-U.S.) subsidiaries. Stip. ¶ 2; Stip. Ex. 2-1 and 2-2.

28. There are significant differences in accounting principles and reporting practices among the United Kingdom and the various nations, including the United States, in which ICI and its worldwide subsidiaries conduct business. The "International Survey of Accounting Principles and Reporting Practices," Price Waterhouse International (Scarborough, Ont. 1979) (the "Survey") identifies several dozen fundamental accounting policies as to which the practices or requirements in sixty-four countries vary widely. Stip. ¶ 32; Stip. Ex. 15. The Survey reports that on some of these points practice is evenly divided worldwide; on others, there is a small but significant minority; on some, what is required in one country is prohibited in another; and on some points in particular, the practice in the United Kingdom differs from that in the United States. A major accounting problem identified by the Survey involves the conversion of transactions from one foreign currency to another. Stip. Ex. ¶ 15.

29. ICI projects that the additional administrative cost of preparing Americas' California franchise tax returns on a worldwide "unitary" basis will be two million pounds sterling initially, plus two million pounds sterling annually. Stip. ¶ 40. The cost of reporting and making accounting adjustments required to conform worldwide information to California accounting includes the cost of maintaining a set of records for ICI and its worldwide subsidiaries to conform to California tax accounting rules and translating the transactions of those

subsidiaries either to United States dollars or to United Kingdom pounds sterling and then to United States dollars. Stip. ¶ 40; Stip. Ex. 22.

#### D. *United Kingdom Tax Credit*

30. Under United Kingdom tax law, a resident corporation is entitled (a) to (direct) credit for foreign taxes paid on dividends from subsidiaries in overseas countries and (b) to (indirect or "underlying") credit for foreign income taxes paid on earnings out of which the dividends are distributed. United States federal income taxes and California franchise taxes, including franchise taxes computed by combining worldwide income of foreign parents and sister companies, may qualify for the United Kingdom indirect credit. Stip. ¶ 37; Stip. Ex. 19. The credit is subject to two limitations:

(a) No credit can be obtained for dividends paid from years in which the dividend paying subsidiary records a net book loss; and

(b) No credit is allowable in excess of the amount of United Kingdom tax payable on the earnings out of which dividends are paid.

31. As a result of these limitations in United Kingdom law, ICI can never obtain credit for California franchise taxes assessed for years in which Americas incurred a net book loss. Stip. ¶ 37; Stip. Ex. 19. The total of these loss year franchise taxes, based on ICI's foreign (to the United States and California) source income is as follows (in dollars) (Stip. Ex. 21):

<i>Income Year Ended</i>	<i>Total Cal. Tax Assessment</i>	<i>Tax on Americas Income</i>	<i>Tax on ICI Group Income</i>
9/30/72	72,956	100	72,856
9/30/73	112,960	200	112,760
12/30/79	391,206	13,287	377,919
12/28/80*	<u>190,000</u>	<u>28,058</u>	<u>161,942</u>
	<u>\$767,122</u>	<u>\$ 41,645</u>	<u>\$725,477</u>

32. For years in which Americas recorded a net book profit, the amount of United Kingdom tax credit available depends on the effective rate of United States federal and state taxes on the underlying earnings. Any California tax that increases the effective rate of tax above the United Kingdom corporate tax rate will be unrelieved upon repatriation of dividends from that year. For the calendar years 1972 through 1982, the United Kingdom corporation tax rate was 52%. This rate declined to 50% in 1983, 45% in 1984, 40% in 1985, and 35% for 1986. The California tax rate was 7.6% for 1972, increasing to 7.95% for 1973, 9% for 1974 through 1979 and 9.6% for 1981 and later years. The current United States federal rate is 46% on all taxable income where taxable income exceeds \$1,000,000. Prior to 1982, the federal corporate rate was, effectively, 48% on taxable income in excess of \$100,000. Where a unitary tax apportionment increases the taxable income of a United States subsidiary corporation of a United Kingdom company, the result is to increase the effective California tax rate beyond 9.6% for United

\* 1982 and subsequent years have not been audited by the Board. The amounts shown in Stip. Ex. 21 for these years are estimates by ICI personnel based on prior years' methodology used by the Board.

Kingdom indirect tax credit purposes since only the book income of the United States subsidiary may be taken into account when computing the amount of foreign tax subject to United Kingdom credit. Stip. Ex. 19.

#### E. *Foreign Objections to Unitary Taxation*

33. The Board's application of the unitary apportionment formula to determine the California taxes of subsidiaries of foreign corporations that, like ICI, have no connection with California except through stock ownership of a subsidiary doing business in California, has resulted in increasingly vigorous objections from the major trading partners of the United States. From 1980 through 1984 the United States Department of State and Department of the Treasury received communications objecting in various terms to worldwide unitary apportionment from the governments of the United Kingdom, Canada, Australia, the Netherlands, Belgium, Switzerland, West Germany, Japan, and the member states of the European Community. Stip. Ex. 17-1 through 17-14. These statements addressed and objected to worldwide unitary apportionment on grounds of double taxation, costs of compliance, interference with foreign commerce and failure of the United States government to speak with one voice in foreign affairs.

34. In 1985, the United Kingdom enacted legislation authorizing the United Kingdom Treasury to impose retaliatory measures on United States' companies doing business in unitary tax states. This legislation became Clause 27 to the Finance Bill of 1985. The retaliatory measure authorized by Clause 27 is withdrawal of

substantial United Kingdom tax credits to United States companies having 7.5% or more of their property, payroll or sales in a unitary state, or having their principal places of business in a unitary state. The provision may be put into effect at any time by the United Kingdom Treasury, subject to the approval of Parliament. Stip. ¶ 35; Stip. Ex. 18.

35. In the Parliamentary debate on Clause 27, Mr. Moore stated the position of the United Kingdom Government:

I shall try to be brief, but the House will understand that it is essential that I express with great care and clarity the Government's attitude to the clause. . . .

The basic objection to unitary tax is that it is contrary to the internationally accepted principle for allocating profits where a company or group operates internationally . . . . The arm's length method is recognized by both the Organization for Economic Cooperation and Development and United Nations, and is enshrined in a worldwide network of bilateral double taxation treaties including the treaties to which the United States is party. It provides a coherent and consistent tax framework for international trade and investment.

For individual companies, as many hon. Members have said, that [unitary tax] means unfair tax bills and excessive compliance costs. It can also produce double taxation. Income earned by the foreign parent of a United States subsidiary is taken into account in the unitary tax bill, and taxes without any relief for overseas tax. Multinational groups can be taxed on more than 100 per cent. of their income in a particular state, and a loss can be turned into a

taxable profit. Another serious objection is the excessive compliance burden imposed by worldwide unitary tax. The method inevitably involves financial information on the worldwide activities of the group, which can be extremely burdensome in practice. [Stip. Ex. 18, p. 11.]

#### F. *The Federal Government's Response*

36. In response to objections made by foreign governments and others, the United States Government on September 23, 1983, announced the establishment of the "Worldwide Unitary Taxation Working Group", chaired by the Secretary of the Treasury and having members appointed by him as representatives of the federal government, state governments and the business community. Stip. Ex. 16.

37. The establishment of the Working Group was described as follows in its Final Report dated August 31, 1984 (Stip. Ex. 16):

Debate on this issue at the federal level spans at least two decades. In its June 27, 1983, decision in *Container*, the U.S. Supreme Court upheld California's right to apply the worldwide unitary method of taxation to U.S.-based multinationals. The Court reserved judgment on the question of whether the worldwide unitary method could constitutionally be applied to foreign-based multinationals. . . .

On September 23, 1983, Treasury Secretary Regan announced President Reagan's decision to refrain from supporting the motion for rehearing in *Container* and to establish a Working Group composed of representatives of the federal government, state governments, and the business community.

The Final Report of the Working Group identified issues and a series of options for compromise but did not arrive at an overall consensus among its members, leaving further action to the various state legislatures rather than Congress. Stip. Ex. 16, p. 5-6.

38. Part of the Final Report consisted of the Chairman's Report. In transmitting the latter to the President by letter dated July 31, 1984, the Secretary of the Treasury stated:

If states enact legislation based on the three principles agreed upon by the Working Group, the United States will be able to speak with one voice in dealing with its foreign trading partners, and this irritant of international commercial relations will have been eliminated.

If there are not sufficient signs of appreciable progress by the states in this area by July 31 of next year, whether by legislation or administrative action, I will recommend to you that the Administration propose federal legislation that would give effect to a water's edge limitation patterned after that in the Chairman's Report. [Stip. Ex. 16, p. iii.]

39. On November 8, 1985, the President issued a Statement (Supp. Stip. ¶ 1; Supp. Stip. Ex. 23) expressing the Federal Government's support for federal legislation requiring that multinational corporations be taxed only on United States income (the "water's edge" limitation) and addressing the taxation of foreign source dividends for domestic corporations. The Statement instructs the Secretary of the Treasury to initiate the federal legislation and instructs the Attorney General to "ensure that the United States' interests are represented in appropriate

controversies and cases consistent with this approach." Supp. Stip. ¶ 23.

40. In response to the President's instruction, Senator Wilson on December 18, 1985, introduced the "Unitary Tax Repealer Act" (Supp. Stip. ¶ 2; Supp. Stip. Ex. 24). In forwarding the Unitary Tax Repealer Act to the President of the Senate and the Speaker of the House of Representatives by letters dated December 18, 1985 (Supp. Stip. ¶ 4; Supp. Stip. Ex. 25), the Secretary of the Treasury stated:

The practice of a small but important minority of the states of assessing corporate income tax on a worldwide unitary basis has caused serious difficulties with the conduct by the federal government of our foreign economic policy. Virtually all of our major investment partners have objected to state practice in this regard. They point out that the worldwide unitary method departs from the principles of international taxation generally followed in the international community and by the federal government. Furthermore, they claim that imposition of the unitary method on their U.S. subsidiaries creates serious administrative burdens in obtaining and converting to U.S. standards accounting information on the foreign affiliates of the unitary group. Finally they argue that the use of the worldwide unitary method may lead to double taxation of the foreign source income of these foreign affiliates. *We agree with these contentions.* These objections have resulted in the adoption of enabling legislation by the United Kingdom permitting serious retaliatory measures to be taken against U.S. companies. It has become clear that the ability of the federal government to speak with one voice in the conduct of foreign economic affairs is significantly weakened because of these state tax practices. [Emphasis added.]

Arguments of federalism and state fiscal sovereignty are not easily overcome. Due concern for rights of the states dictate that they be granted great leeway to tailor their own systems of taxation. However, in this instance the lack of a solution will certainly yield serious international ramifications, including foreign sovereign retaliation against innocent bystanders. Therefore, the Congress must insert itself into the process in order to avoid a serious disruption of international commerce and so that a solution can be forged.

Senator Wilson's statement introducing the Unitary Tax Repealer Act includes a similar description of the reasons for the bill. Supp. Stip. Ex. 24.

Dated this 31st day of January, 1986:

Respectfully submitted,

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UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF ILLINOIS  
EASTERN DIVISION

IMPERIAL CHEMICAL	) No. 84-C-8906
INDUSTRIES PLC,	) (Judge Williams)
Plaintiff,	) DEFENDANTS'
	) RESPONSE TO
v.	) PLAINTIFF'S SUMMARY
THE FRANCHISE TAX	) STATEMENT OF
BOARD OF THE STATE OF	) STIPULATED FACTS
CALIFORNIA, operating	)
through its Chicago office,	)
et al.,	)
Defendants.	)

Although the parties to this action have executed a Joint Stipulation of Facts (twice supplemented), plaintiff has deemed it appropriate to prepare on its own a "Summary Statement of Stipulated Facts." In doing so, plaintiff has inappropriately paraphrased a number of stipulated facts and referred to "facts" that are neither recited in the Joint Stipulation of Facts or otherwise reflected in the record. The particular statements in the Summary in

which such liberties have been taken are set forth below with defendants' comments.

This response to the Summary prepared by plaintiff is not to be construed as necessarily conceding the materiality of all of the facts recited in the Summary. In addition, defendants' response is not to be construed as conceding either that plaintiff has recited all material facts contained in the Joint Stipulation or accurately characterized or described the additional facts set forth in the stipulated exhibits. The interpretation and significance of the stipulated facts and exhibits are matters to be covered in legal argument. The following comments therefore relate only to those statements of plaintiff that inappropriately paraphrase the facts as stipulated or refer to alleged facts that do not appear in the record.

STATEMENT NO. 15

" . . . the Board recomputed business income subject to California tax by applying the three factor apportionment using as the apportionment base the assumed worldwide income of the ICI Group. Stip. ¶14."

*Comment:*

The word "assumed" does not appear in paragraph 14 of the Joint Stipulation. The comparable sentence reads: " . . . the Board recomputed ICI Am's net income subject to California tax by applying the unitary apportionment method of accounting, using as the apportionment base the worldwide income of the ICI Group." See also Stip., ¶30, which states that for purposes of this

litigation ICI does not contest the factual correctness of the Board's application of the unitary method.

#### STATEMENT NO. 19

"In computing the ICI Group's income apportionable to California, the Board began with the consolidated income of the ICI Group shown in the financial statements contained in ICI's published annual reports, expressed in pounds sterling. Adjustments based on information contained in the published annual reports were made by the Board purporting to eliminate exchange rate gains and losses and the earnings of corporations owned 50 percent or less by ICI. Adjustments were also made by the Board to the earnings of ICI purporting to conform the statements to California tax accounting. The Board eliminated nonbusiness income for 1971-1975. For 1976-1980, however, dividends from 50% or less owned subsidiaries of ICI were included as business income. Stip. ¶ 21."

#### *Comment:*

(1) The opening phrase of this statement obviously is designed to create the impression that the proposed taxes are being asserted against the ICI Group. The opening phrase or paragraph 21 of the Joint Stipulation actually reads: "In computing the income attributable to ICI Am's California activities. . . ."

(2) ICI twice uses the word "purporting." This word does not appear in the stipulated facts.

#### STATEMENT NO. 24

" . . . Americas believes that increased assessments for years after 1981, including 1983, a loss year for Americas, are likely to be proposed by the Board on the same unitary basis as earlier years. Stip. ¶29."

#### *Comment:*

There is nothing in the record with regard to 1983 being a "loss year" for Americas.

#### STATEMENT NO. 25

" . . . Much of the information requested [from Americas] was not readily available from any source and is outside the scope of ICI's accounting records. Stip. ¶¶26 and 31; Stip. Ex. 9."

#### *Comment:*

This statement is unsupported by the record. Paragraph 26 of the Joint Stipulation merely refers to correspondence between the Board and iCI Am and Paragraph 31, to the annual "T" forms filed by ICI's subsidiaries. Exhibit 9 is a follow-up letter from the Board's auditor to ICI Am.

#### STATEMENT NO. 26

" . . . The "T" form is the only standard financial report submitted regularly to ICI by its worldwide subsidiaries. Stip., ¶31."

*Comment:*

Paragraph 30 of the Joint Stipulation states that the "T" form is the "basic," not the "only," financial report submitted to ICI by its subsidiaries.

Dated: March 27, 1986

Respectfully submitted,  
 JOHN K. VAN DE KAMP  
 Attorney General of the  
 State of California  
 /s/ Patricia Strelhoff  
 PATRICIA STRELOFF  
 Deputy Attorney General  
 Attorneys for all Defendants

---

UNITED STATES DISTRICT COURT  
 NORTHERN DISTRICT OF ILLINOIS  
 EASTERN DIVISION

IMPERIAL CHEMICAL	) No. 84-C-8906
INDUSTRIES PLC	) (Judge Williams)
	)
Plaintiff,	)
	) SECOND SUPPLEMEN-
v.	) TAL JOINT STIPULA-
	) TION OF FACTS
THE FRANCHISE TAX	)
BOARD OF THE STATE OF	)
CALIFORNIA, operating	)
through its Chicago office;	)
and LEONARD WILSON,	)
individually and as District	)
Manager, Chicago Office of	)
the State of California	)

Subsequent to the filing of a Supplemental Joint Stipulation of Facts on 31 January, certain additional facts have occurred that the parties now desire to adduce in this Second Supplemental Joint Stipulation of Facts.

IT IS STIPULATED AND AGREED by the parties through their respective counsel that:

On 30 January 1986, the United States Secretary of State transmitted a letter to the Governor of California concerning Worldwide Unitary Taxation. A copy of this letter is attached as Exhibit 24. This exhibit is incorporated by reference and may be entered into evidence as fact as though proven in open court except as herein expressly provided.

This stipulation shall not be construed as concession by any party of relevancy or materiality of facts stipulated. The parties expressly reserve the right to argue

relevancy or materiality of any of the facts herein recited. This stipulation shall apply only in the above-entitled action and in any appeal from the judgment of this Court.

This Second Supplemental Joint Stipulation is made this 20th day of February 1986.

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UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF ILLINOIS  
EASTERN DIVISION

ALCAN ALUMINIUM	) No. 84-C-6932
LIMITED,	) (Judge Williams)
	)
Plaintiff,	)
	) DEFENDANTS' CROSS-
v.	) MOTION FOR SUM-
	) MARY JUDGMENT
THE FRANCHISE TAX	)
BOARD OF THE STATE OF	)
CALIFORNIA, operating	)
through its Chicago office,	)
et al.,	)
	)
Defendants.	)

Pursuant to Rule 56 of the Federal Rules of Civil Procedure, defendants move for summary judgment in the above-entitled action on the grounds that the Court lacks jurisdiction to entertain this action and that defendants are entitled to judgment as a matter of law. Said grounds are fully discussed in the accompanying Memorandum of Points and Authorities in Opposition to Motion for Summary Judgment and in Support of Cross-Motion for Summary Judgment.

Dated: March 27, 1986

Respectfully submitted,  
 JOHN K. VAN DE KAMP  
 Attorney General of the  
 State of California  
 /s/ Patricia Streloff  
 PATRICIA STRELOFF  
 Deputy Attorney General  
 Attorneys for all Defendants

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UNITED STATES DISTRICT COURT  
 NORTHERN DISTRICT OF ILLINOIS  
 EASTERN DIVISION

IMPERIAL CHEMICAL	) No. 84-C-8906
INDUSTRIES PLC,	) (Judge Williams)
-Plaintiff,	)
v.	) DEFENDANTS' CROSS-
THE FRANCHISE TAX	) MOTION FOR SUM-
BOARD OF THE STATE OF	) MARY JUDGMENT
CALIFORNIA, operating	)
through its Chicago office,	)
et al.,	)
Defendants.	)

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Dated: March 27, 1986

Respectfully submitted,

JOHN K. VAN DE KAMP  
Attorney General of the  
State of California

/s/ Patricia Streloff  
PATRICIA STRELOFF  
Deputy Attorney General  
Attorneys for all Defendants

---

In The  
**Supreme Court of the United States**  
October Term, 1988

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA; LEONARD WILSON, Individually and as District Manager, Chicago Office of the Franchise Tax Board of the State of California; and B. M. RARANG, Individually and as Auditor, Chicago Office of the Franchise Tax Board of the State of California,

*Petitioners,*

v.

ALCAN ALUMINIUM LIMITED AND IMPERIAL  
CHEMICAL INDUSTRIES PLC,

*Respondents.*

ON WRIT OF CERTIORARI TO THE UNITED STATES  
COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONERS

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5922

### QUESTIONS PRESENTED

1. Whether a foreign company which is the sole stockholder of an American subsidiary has standing to challenge in federal court the accounting method by which the State of California determines the locally taxable income of that subsidiary.

2. Whether, assuming that requisite standing exists in such an instance, a federal action for injunctive and declaratory relief is nevertheless barred by the Tax Injunction Act (28 U.S.C. § 1341) or the principle of comity which underlies the Act.

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No. 88-1400

In The

## Supreme Court of the United States

October Term, 1988

FRANCHISE TAX BOARD OF THE STATE OF CALIFOR-  
NIA; LEONARD WILSON, Individually and as District  
Manager, Chicago Office of the Franchise Tax Board of  
the State of California; and B. M. RARANG, Individually  
and as Auditor, Chicago Office of the Franchise Tax Board  
of the State of California,

Petitioners,

v.

ALCAN ALUMINIUM LIMITED AND IMPERIAL  
CHEMICAL INDUSTRIES PLC,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES  
COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONERS

OPINIONS BELOW

The decision of the Court of Appeals for the Seventh  
Circuit (Pet. App., A1-A20) is reported at 860 F. 2d 688.  
The opinion of the District Court for the Northern District  
of Illinois, Eastern Division (Pet. App., A21-A27) is not  
reported.

## JURISDICTION

The judgment of the Court of Appeals for the Seventh Circuit was entered on October 19, 1988. A petition for rehearing en banc was denied on January 9, 1989. On January 24, 1989, the Court of Appeals granted petitioners' motion for a stay of mandate for a period of 30 days to enable petitioners to file a petition for a writ of certiorari. The petition for a writ of certiorari was filed on February 22, 1989 and was granted on April 17, 1989. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

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## STATUTORY PROVISION INVOLVED

28 U.S.C. § 1341:

"The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."

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## STATEMENT OF THE CASE

### A. General Background.

The consolidated actions in this matter were brought by two foreign corporations seeking to challenge, by way of declaratory and injunctive relief, the unitary business/formula apportionment method of accounting under which the Franchise Tax Board of the State of California has proposed to determine the taxable income of the foreign companies' American subsidiaries properly allocable to California.<sup>1</sup> The two suits were filed in the

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<sup>1</sup> In *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983), this Court upheld the constitutionality of California's

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Northern District of Illinois, with jurisdiction over the subject matter being based on 28 U.S.C. §§ 1331, 1337, 1343 and 2201. Named defendants in one suit are the Franchise Tax Board and two employees assigned to its Chicago office; in the other, the Franchise Tax Board and a single Chicago employee. Said party-defendants are hereinafter collectively referred to as "the Board."

Plaintiffs-respondents are Alcan Aluminium Ltd. ("Alcan") and Imperial Chemical Industries PLC ("Imperial"). Alcan, a Canadian company, is the indirect parent of Alcan Aluminum Corporation ("Alcancorp"), a company organized under the laws of Ohio. Imperial, a British company, is the indirect parent of ICI Americas, Inc. ("Americas"), a company organized under the laws of Delaware.<sup>2</sup> Although Alcancorp and Americas are the

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method of taxation as applied to a domestic company with foreign subsidiaries, rejecting the contention that California was required to determine the locally taxable income of that company under the separate accounting/arm's length method of taxation used by the Federal Government and various foreign jurisdictions. However, the Court specifically left open the question whether the unitary business/formula apportionment method of accounting is constitutionally permissible when the taxpayer is a domestic subsidiary of a foreign parent. See 463 U.S., at 189, n. 26. That ultimate issue is not before this Court at this time. Only if this Court were to decide both the standing issue and the section 1341/comity issues against California's position would that ultimate constitutional issue be ripe for consideration on the merits by the District Court on remand.

<sup>2</sup> Since during the income years involved both Alcan and Imperial were ultimate parents of wholly-owned chains of subsidiaries leading to Alcancorp and Americas, respectively, Alcan and Imperial shall be referred to herein as the "sole stockholders" of their respective subsidiaries.

corporate taxpayers involved here, neither is a party to either lawsuit.

During the years in question, the two American subsidiaries, AlcanCorp and Americas, conducted business in California and were therefore subject to the state's corporate tax laws. The Board has determined that the taxable income of those companies should be calculated under the unitary business/formula apportionment method of accounting. Under this method of accounting, the results and activities of all commonly controlled entities which function as a single or unitary business are combined and a portion of such overall results is then assigned to California based on a comparison of the activities conducted in California to the activities of the unitary business everywhere. Generally the comparison is made by employment of a three-factor formula based on relative property, payroll and sales.

For purposes of this litigation, neither respondent has contested the Board's findings that their respective subsidiaries were engaged in unitary enterprises with their parent companies. JA 54, 63.<sup>3</sup> Both contend, however, that the Board's use of the unitary business/formula apportionment method of accounting to calculate the taxable income of their respective subsidiaries imposes an unconstitutional burden on the conduct of foreign commerce.

The allegations in the complaints filed by the two parent companies, both of which refer to California's

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<sup>3</sup> Stipulations of fact (JA 37 - 100, 131-132), with voluminous exhibits attached, were filed in the District Court in anticipation of the legal issues in the two cases being resolved through cross-motions for summary judgment. Thus, there is a comprehensive factual record in both cases, in contrast to the typical situation in which a court is called upon to decide a question of standing solely or largely on the pleadings.

accounting method as "worldwide unitary income taxation," are nearly identical. Alcan alleges that, as a result of the method of taxation employed by California, Alcan "has been required to produce information regarding its non-United States activities," which "has resulted in an administrative and financial burden;" that, "unless restrained . . . [the Board] will continue to impose such worldwide unitary income taxation upon [Alcan] and its non United States subsidiaries;" that California's method of taxation "constitutes impermissible double taxation" in violation of the Foreign Commerce Clause; and that "using worldwide unitary income as a base for taxation, [sic] imposes a tax upon [Alcan] and its non-United States subsidiaries. . . ." JA 9-10. Similarly, Imperial alleges in its complaint that "[u]tilizing [Imperial's] 'worldwide unitary income' as a base for taxation imposes a California tax upon [Imperial] and its foreign (to the United States) subsidiaries;" that, as a result of the Board's method of computing taxes, Imperial "has been required to incur administrative and financial burdens and continues to be under such burdens;" and that the imposition by the Board of "'worldwide unitary income taxation' upon [Imperial] and its subsidiaries . . . constitutes impermissible double taxation and interferes with the foreign commerce of the United States and the commerce of other nations in violation of the Foreign Commerce Clause. . . ." JA 19-20. Both of the parent companies pray that the Board be enjoined from assessing, levying or collecting any tax, the amount of which is determined, in whole or in part, by reference to the worldwide income of the plaintiffs and their subsidiaries, and that the Board's imposition of "worldwide unitary income taxation" be

declared void, unenforceable, and in violation of the Constitution.

### B. The Alcan Group.

At all relevant times, Alcan and its subsidiaries (the "Alcan Group Companies") engaged in all phases of the aluminum business on an international scale. JA 64. Nearly 100 of Alcan's subsidiaries operated wholly outside the United States. *Ibid.* As previously noted, Alcan itself was a corporation organized and existing under the laws of Canada; it had its headquarters and principal place of business in Montreal, Quebec. *Ibid.* Neither Alcan nor any of its non-United States subsidiaries had a permanent place of business in the United States. JA 65.

Alcancorp, a second-tier subsidiary of Alcan, was organized under the laws of the State of Ohio, and had its principal place of business in Cleveland, Ohio. JA 65. This subsidiary engaged in the business of fabricating and selling aluminum products in the United States. JA 66. It was duly qualified to do business in California and in fact conducted certain of its business activities there, principally the operation of a large manufacturing facility in Riverside, California. JA 66-67.

Upon audit of Alcancorp's tax returns for the years 1965 and 1966, the Board determined that Alcancorp and its immediate parent, Aluminium Company of Canada, Limited ("Alcan Canada"), were engaged in a single unitary business. JA 68. Accordingly, the Board combined the income and activities of Alcancorp and Alcan Canada to determine the income of Alcancorp attributable to California, subsequently issuing notices of proposed assessments based on this unitary treatment. JA 69. Alcancorp, while not agreeing with the Board's right to combine the

activities of Alcancorp with Alcan Canada, or with other members of the corporate group headed by Alcan, requested that the notices of proposed assessment be modified to include all companies in the group. *Ibid.*

The Board has since audited, or is in the process of auditing, Alcancorp's returns for the years 1967 through 1974 and 1976 through 1981. JA 69; Alcan Stip., Exh. II (Supp. App., Item 3). Pursuant to these audits and the resultant administrative review process, the Board has determined that Alcancorp is part of a single unitary enterprise conducted by the Alcan Group Companies. *Ibid.* As a result, the Board has calculated Alcancorp's tax liability through 1978 on an apportioned share of the total business income of the unitary business conducted by all members of the group. *Ibid.* The apportionment fraction applied to such income has been calculated by reference to the ratio of Alcancorp's California property, payroll and sales to all of the property, payroll and sales of the unitary business conducted by the Alcan Group Companies. *Ibid.*

Alcancorp has paid the taxes so calculated for the years 1965 through 1974 and has pursued its administrative remedies with the Board. JA 76. It has also filed two actions for refund of these taxes in the California courts. *Ibid.*; Alcan Stip., Exhs. XIX-1 and 2 (Supp. App., Items 4 and 5). These actions are presently pending. *Ibid.*

All taxes assessed or proposed to be assessed by the Board are against Alcancorp. JA 99. The Board has not sent assessment notices to Alcan or any of the Alcan Group Companies which is not doing business in California. *Ibid.* The Board has not directed any correspondence to Alcan or any of the Alcan Group Companies which is not doing business in California. *Ibid.*

### C. The Imperial Group.

Imperial is an English public limited company having its principal office and place of business in London, England. JA 38. It does not maintain a place of business in the United States, though it has an office in New York which is used by company officials when they are visiting the United States on business. *Ibid.*

Imperial owns, directly or indirectly, a majority interest in some 400 subsidiaries operating throughout the world. JA 39-40. The business activities of Imperial and its subsidiaries in Western Europe comprise 13 principal business groupings: agriculture, agrochemicals and colours, fibres, general chemicals, industrial explosives, oil, organics, paint, petrochemicals and plastics, pharmaceuticals, polyurethanes, plant protection, and speciality chemicals and materials. JA 38-39. The agrochemicals, pharmaceuticals and oil operations are conducted on a worldwide basis. *Ibid.*

Americas, the entity subject to California taxation, is a Delaware corporation. JA 41. It is the principal operating subsidiary of Imperial in the United States. *Ibid.* During the period 1971 through 1981, Americas conducted business in California through ownership and operation of a pharmaceutical manufacturing plant in Pasadena and other activities. *Ibid.*

Americas filed franchise tax returns with the Board for income years ending 1972 through 1981. JA 43. For those years in which Americas reported net income, it apportioned income to California on the basis of a three-factor formula, using California property, California payroll and California sales as the numerators and all property, payroll and sales of Americas as the denominators.

*Ibid.* Upon audit, the Board determined that Americas was part of a unitary enterprise conducted by all members of the group of companies headed by Imperial (the "ICI Group"). JA 46. Based on this determination, the Board recomputed Americas' net income subject to California tax, using as the apportionment base the worldwide income of the group. *Ibid.*

The Board issued Notices of Proposed Assessment against Americas in accordance with its determination that the domestic company was part of a unitary enterprise conducted by the ICI Group. JA 47-49. After the filing of a protest by Americas, the Board adjusted the assessments which had erroneously included certain items in the group income. JA 49-50. As a result of such adjustments, the Board's asserted liability for the year 1981 is less than Americas' self-assessed tax based on the supposition that only the activities of Americas constituted the conduct of a unitary business. JA 44-45, 47-48, 51.

Americas paid the additional assessments for 1972-1975, and timely filed claims for refund with the Board protesting the calculation of Americas' California tax on the basis that it is part of a unitary business conducted by the ICI Group. JA 53. Americas also has filed a protest of the proposed assessment, calculated on the same basis, for years 1976 through 1981. JA 53-54.

The Board has not directed any correspondence to Imperial or any member of the ICI Group other than Americas. JA 53. All taxes assessed or proposed to be assessed by the Board are against Americas. *Ibid.* The Board has not assessed or proposed to assess taxes against Imperial or any member of the ICI Group other than Americas. *Ibid.*

#### D. Proceedings Below.

Upon institution of the lawsuits by Alcan and Imperial, the Board filed motions to dismiss, asserting, *inter alia*, that the respective plaintiffs lacked standing to challenge the state tax treatment of their domestic subsidiaries. The District Court initially ruled in Alcan's favor on the standing question. JA 26-27. Acting upon a motion for relatedness filed by Imperial, the District Court thereafter reassigned the Imperial case to the judge handling the Alcan matter, and the Board withdrew its motion to dismiss Imperial's action. JA 30. Subsequently, in joint proceedings, each of the parties moved for summary judgment, with the Board again urging that requisite standing was lacking. On reconsideration of the standing question, the District Court held that respondents were subject to the general rule prohibiting shareholder suits to redress corporate injuries. It rejected the foreign parents' contentions that they suffer injuries distinct from those of their subsidiaries because California's method of taxation allegedly results in double taxation of their income and requires that they bear a substantial portion of the compliance costs. Accordingly, the District Court ordered that both actions be dismissed. Pet. App., A27.

Alcan and Imperial appealed to the Seventh Circuit Court of Appeals, which reversed the order of dismissal and remanded the matter for further proceedings. The Court of Appeals first stated that cases applying the shareholder standing rule fall into two categories: (1) those which bar standing to avoid the manipulation of diversity jurisdiction or a threatened interference with

corporate management, and hence "are animated by concerns about the limits on judicial power and the appropriateness of a particular plaintiff bringing a particular action," and (2) those which bar standing to avoid a multiplicity of suits, and hence are animated by mere "housekeeping concerns" of the federal judiciary. Pet. App., A10-11. The court then concluded that a denial of standing in the present cases would serve only the latter objectives, and, implicitly, that standing requirements are less stringent in this category of cases. See, e.g., Pet. App., at A11 (" . . . in addressing whether injuries to foreign parents are sufficiently direct to confer standing, we attend to which of the several aims of the shareholder standing 'rule' would be served by its invocation"). While apparently agreeing with the District Court that the alleged compliance costs and double taxation of income would not constitute direct injuries to the parent companies, see Pet. App., at A13-14, the court went on to find a "direct and independent injury" that had escaped even the attention of the respondent corporations. The Court of Appeals held that from the standpoint of foreign companies the unitary business/formula apportionment method of accounting employed by California diminishes the attractiveness of owning American subsidiaries as compared to conducting foreign commerce through contracts with independent companies; that the accounting method therefore burdens foreign companies' decisions to conduct foreign commerce through American subsidiaries; and that this burden on the decision-making of foreign companies is a direct and independent injury sufficient for standing purposes. Pet. App., at A15-17.

Turning next to the proscriptions of the Tax Injunction Act (28 U.S.C. § 1341), the Court of Appeals deemed

the Act to be inapplicable to the suits filed by Alcan and Imperial for declaratory and injunctive relief, stating that "the Act has not been construed so broadly as to bar a nontaxpayer (like the parent companies involved here) who lacks a remedy in state court from bringing suit in federal court on the ground that an affiliated taxpayer possesses adequate state court remedies." Pet. App., at A18. The court then considered the principle of comity underlying the Act. It stated that the Act "left intact federal courts' 'discretionary power to grant or withhold relief so as to avoid needless obstruction of the domestic policy of the states' " and that, in some circumstances, "this discretion, guided by considerations of comity and federalism, may be exercised to bar suits against state tax assessments to which the Tax Injunction Act is inapplicable." Pet. App., at A18. It held, however, that "comity and federalism, weighty as these concerns are where the federal courts pass on the constitutionality of state tax legislation, cannot justify withholding federal jurisdiction from a party with no cause of action in state court to redress its own direct and independent injury." Pet. App., at A19.

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#### SUMMARY OF ARGUMENT

The two questions presented in this matter are closely intertwined. In a previous case in which a foreign parent company unsuccessfully sought to challenge California's tax treatment of a domestic subsidiary, the District Court aptly stated that, in determining whether a parent company has standing to make such a challenge, the "salutary purposes [of the Tax Injunction Act] should be kept in mind." *Shell Petroleum, N.V. v. Graves*, 570 F.

Supp. 58, 61 (N.D. Cal. 1983), aff'd, 709 F. 2d 593 (9th Cir. 1983), cert. den., 464 U.S. 1012 (1983). Similarly, when considering the applicability of the Tax Injunction Act in an action of this nature, the adequacy of alternative state remedies can fairly be determined only in light of the parent company's status as a corporate stockholder, particularly when the domestic subsidiary is wholly owned.

The coalescence here of the stockholder standing rule and the federal policy expressed in the Tax Injunction Act dictates that the propriety of the parent companies' suits to obtain injunctive relief against the California taxing authorities be judged against a stringent standard of justiciability. The initial error of the Court of Appeals is its conclusion to the contrary. The court has expressed the view that the issue of stockholder standing in state tax matters implicates only the "housekeeping concerns" of the federal judiciary, as opposed to "concerns about the limits on judicial power and the appropriateness of a particular plaintiff bringing a particular action." Pet. App., at A10-A11. Such an approach is inconsistent with the long-established policy against federal intrusion in matters involving state taxation. See, e.g., *Fair Assessment in Real Estate v. McNary*, 454 U.S. 100, 102 (1981). In addition, while the Court of Appeals has stated that historically one of the major purposes of the stockholder standing rule was to curb the use of stockholder suits to invoke federal diversity jurisdiction where a corporation itself could not, Pet. App., at A8, it has failed to recognize the parallelism in the present case. A federal suit brought by a sole stockholder to challenge state taxation when a suit by the corporate taxpayer would be barred by the Tax Injunction Act is just as objectionable as a collusive suit brought by one of several stockholders to obtain

access to a federal forum when the corporation itself could not satisfy diversity requirements.

The stockholder standing rule cannot be avoided by an allegation of injuries to the stockholder that are merely the indirect result of injuries to the corporation. *Pittsburgh & W. Va. Ry. v. U.S.*, 281 U.S. 479, 486 487 (1930). A stockholder may bring an individual action, however, when he is injured directly and independently of the corporation. See, generally, 12B W. Fletcher, *Cyclopedia on the Law of Corporations* (Rev. Perm. ed. 1984), § 5911. In the courts below, Alcan and Imperial argued that their actions against the Board fall within this exception to the general rule due to their allegations that taxation of their domestic subsidiaries under the unitary business/formula apportionment method of accounting employed by California (1) results in double taxation of income in which the parent companies have an interest and (2) requires that they bear a substantial portion of the compliance costs. The Court of Appeals did not accept these arguments. Nonetheless, under its relaxed standard of justiciability, the court held that California's accounting method directly injures the parent companies by burdening their decisions to conduct foreign commerce through American subsidiaries.

The conclusion of the Court of Appeals that California's method of taxation burdens the decision-making of foreign companies appears to be based on the theory that when such companies choose to operate through American subsidiaries, and they conduct foreign operations at less cost than in California, a higher proportion of the unitary business' worldwide income will be attributed to California under the unitary scheme than would be the case "if [the parent company] engaged in precisely the

same foreign commerce through arm's length contracts with unaffiliated companies." Pet. App., at A16-17. The reasoning is faulty in two respects. Not only does it erroneously assume that foreign companies can conduct "precisely the same foreign commerce" through either an American subsidiary or an independent contractor, but it also assumes that foreign companies conducting business in California through unaffiliated companies would have taxable income determinable on a separate accounting basis. In fact, in the unlikely event that a foreign company were to incur *any* tax liability in California through its dealings with an independent contractor, that liability would be determined under the unitary apportionment method. From this standpoint, therefore, the unitary method cannot be viewed as a burden on a foreign company's decision to conduct foreign commerce in one form or another; that method would be used to determine *any* tax liability arising from unitary operations. The choice between conducting commerce through a subsidiary or an independent contractor would more likely entail a choice between some California tax or none at all. But even the Court of Appeals has not suggested that, because California would impose a tax on one of the group's companies in one instance but not the other, the imposition of *any* California tax is such a "burden" on a foreign company's decision-making as to give it standing to challenge the legality of that tax in federal court.

The Court of Appeals also has erred in concluding that the asserted burden on foreign companies' decision-making is a cognizable injury for standing purposes. A foreign company which can conduct "precisely the same foreign commerce" through either an American subsidiary or an independent contractor is free to select the

alternative which it considers most advantageous tax-wise. Furthermore, any injury to the parent companies in the present case (both of which already have made the choice to conduct foreign commerce through American subsidiaries) is merely the indirect result of the manner in which the Board has determined to calculate their subsidiaries' taxable income. The parties directly injured by the alleged wrongful acts of the Board are the corporate taxpayers. The fact that the foreign companies may be said to utilize their domestic subsidiaries as "instrumentalities of foreign commerce" is not substantive support for the Court of Appeals' holding that respondents suffer direct injuries that are independent of those to the domestic subsidiaries.

Respondents' own allegations of independent injury are without merit. The burden of double taxation, if any, falls on the corporate taxpayers which have been assessed the taxes that Alcan and Imperial claim are invalid under the Foreign Commerce Clause. The subsidiaries also bear the direct burden of any compliance costs. No information has been sought from the parent companies themselves.

The stockholder status of Alcan and Imperial also should serve to raise the bar of the Tax Injunction Act. As the sole stockholders of their respective subsidiaries, both of the parent companies effectively have alternative state remedies since they are in a position to ensure that the state remedies afforded to the actual taxpayers are pursued with vigor. In *South Carolina v. Regan*, 465 U.S. 369 (1984), this Court recognized, by way of dictum, that such practical considerations should govern the determination of whether a nontaxpayer has alternative remedies to seeking injunctive relief against taxing authorities. See

465 U.S., at 381, n. 19. There is also persuasive authority to the effect that a federal court should not entertain a stockholder's suit that is brought to circumvent the Anti-Injunction Act (26 U.S.C. § 7421(a)), which, in language analogous to that contained in the Tax Injunction Act, bars a suit "for the purpose of restraining the assessment or collection of any [federal] tax."

Both Alcan and Imperial have argued at one time or another that the state remedies available to their domestic subsidiaries are inadequate, insofar as the parent companies are concerned, because the subsidiaries would be unable to raise the constitutional claims that are "peculiar" to the parents. The parent companies, however, do not have peculiar rights under the Foreign Commerce Clause, see, e.g., *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 127-128 (1978), and thus do not have any peculiar claims to assert. The taxpayer-subsidiaries, on the other hand, as the parties directly concerned with the California tax assessments, clearly would have the right in the state courts to raise any and all constitutional objections to the taxes they are required to pay.

Finally, if it should be determined that the Tax Injunction Act does not bar a stockholder's suit which seeks to challenge state taxation of a corporate taxpayer, there is an obvious gap in the law. This gap should be closed by a reaffirmation of the principle of comity underlying the Act. It makes no sense that the "salutary purposes" of the Tax Injunction Act should fall by the wayside simply because an action is brought in the name of a sole stockholder rather than in the name of the corporate taxpayer.

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## ARGUMENT

## I

**THE HOLDING BELOW THAT FOREIGN PARENT COMPANIES HAVE STANDING TO CHALLENGE THE STATE TAXATION OF THEIR DOMESTIC SUBSIDIARIES IS AN ILL-FOUNDED DEPARTURE FROM TRADITIONAL STANDING RULES THAT WOULD RESULT IN UNPRECEDENTED FEDERAL INTRUSION IN STATE TAX MATTERS.**

**A. A stockholder's effort to obtain federal relief against state taxation of a corporate taxpayer dictates adherence to a stringent standard of justiciability.**

This Court has long recognized "the important and sensitive nature of state tax systems and the need for federal court restraint when deciding cases that affect such systems." *Fair Assessment in Real Estate v. McNary*, 454 U.S. 100, 102 (1981). Thus, even prior to the enactment of the Tax Injunction Act (28 U.S.C. § 1341), the Court espoused a principle of equitable restraint in state tax matters. As it explained in *Matthews v. Rodgers*, 284 U.S. 521, 525 (1934):

"The reason for this guiding principle is of peculiar force in cases where the suit . . . is brought to enjoin the collection of a state tax in courts of a different, though paramount sovereignty. The scrupulous regard for the rightful independence of state governments which should at all times actuate the federal courts, and a proper reluctance to interfere by injunction with their fiscal operations, require that such relief should be denied in every case where the asserted federal right may be preserved without it."

The Tax Injunction Act reinforces this principle of noninterference with state tax administration, but does not supplant it. On the contrary, this Court has held that the principle of comity underlying the Act is so compelling as

to preclude federal intrusion in state tax matters even in situations not specifically covered by the Act. See *Fair Assessment in Real Estate v. McNary*, *supra* (holding that the principle of comity precludes a suit for monetary damages under 42 U.S.C. § 1983); see also *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293 (1943).

The Court of Appeals' whole approach to the standing issue in the present matter is inconsistent with this line of authority. When addressing the issue of standing, the Court disregards the fact that these stockholder suits seek declaratory and injunctive relief against state taxing authorities. Instead the Court says that since the suits do not involve a manipulation of diversity jurisdiction or a threat to corporate management, the stockholders' standing only implicates the court's "housekeeping concerns," as opposed to "concerns about the limits on judicial power and the appropriateness of a particular plaintiff bringing a particular action." Pet. App., at A10-A11. Only *after* the court concludes that the Board has invoked the stockholder standing rule in an area "where its underpinnings are weakest" (Pet. App., at A17), and only *after* the Court concludes that "housekeeping concerns" do not warrant a denial of standing, does the Court proceed to recognize "that 'the principle of comity militates in favor of a stringent standard of justiciability in cases that threaten to interfere with state taxes.'" Pet. App., at 19. The Board submits that this is a backward approach to the standing issue which is clearly erroneous. A shareholder's suit brought to challenge state taxation of a

corporate taxpayer belongs at the top of the Court of Appeals' totem pole, not at the bottom.<sup>4</sup>

Furthermore, the Court of Appeals' analysis of the stockholder standing rule is historically inaccurate. Even the so-called "traditional limitations on shareholder standing" which the court places at the top of its totem pole cannot properly be characterized as merely "judge-made restrictions on the availability of the federal courts." Pet. App., at A10. In fact, the rule predates the federal court system. As is evident from this Court's decision in *Hawes v. City of Oakland*, 104 U.S. 450 (1881), a case cited by the Court of Appeals, the rule goes back to

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<sup>4</sup> The Court of Appeals states in its opinion that "The FTB does not seriously contest plaintiffs' claims that their interest in challenging the California franchise tax satisfies the case or controversy requirement." Pet. App., at A5. On the contrary, the Board has never accepted the proposition that a shareholder seeking to redress a corporate injury has standing in the constitutional sense. Article III "requires the party who invokes the Court's authority to 'show that he personally has suffered some actual or threatened injury.'" *Valley Forge College v. Americans United*, 454 U.S. 464, 472 (1982); emphasis added. The legal basis for the general rule that only a corporation and not its shareholders can complain of an injury or wrong done to the corporation is that a stockholder is not personally injured by a wrong done to the corporation; his rights are derivative. *Pittsburgh & W. Va. Ry. v. U.S.*, 281 U.S. 479, 487 (1930). Thus, although the cases dealing with stockholder standing generally have constituted a line of authority separate from that dealing with standing under Article III (see, however, *EMI Ltd. v. Bennett*, 738 F. 2d 994, 996 (9th Cir. 1984), cert. den., 469 U.S. 1073 (1984)), it remains open to question whether a sole or controlling shareholder's ownership interest in a corporation is sufficient by itself to satisfy the "injury in fact" requirement of Article III. In any event, even if the "injury in fact" requirement is satisfied, it is clear that such a stockholder may pursue an individual action only upon the showing of a direct injury which is independent of any injury to the corporation. See, *supra*, at 22-25.

the English common law and is based on the fact that a corporation is an entity separate from its stockholders. *Id.*, at 455. The *Hawes* case itself involved the misuse of an exception to the rule prohibiting a stockholder's action to redress a corporate injury, namely, the maintenance in equity of a so-called derivative suit. The Court was particularly concerned with increasingly common situations in which corporations, "instead of resorting to the State courts, which are their natural, their lawful, and their appropriate forum" (*id.*, at 452) would collude with an out-of-state stockholder in order to satisfy the requirements of diversity jurisdiction where a federal action was not otherwise available. *Id.*, at 452-453. See also *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 529-533 (1983).

The Court of Appeals has missed the parallelism between a collusive suit brought by one of several stockholders to enable a corporation to obtain access to a federal forum, and a suit brought by a sole stockholder of a corporation to accomplish the same objective. Due to the proscriptions of the Tax Injunction Act, neither of the actual taxpayers in the present matter can seek declaratory and injunctive relief against the California tax assessments in federal court. At the same time, though the Court of Appeals is reluctant to concede the point (see Pet. App., at A4-A5), it should be evident that the actual taxpayers can voice any and all Foreign Commerce Clause objections to the tax assessments in the state courts. Under these circumstances, the federal suits brought in the names of the sole stockholders serve no purpose other than to provide the corporate taxpayers with a federal forum — a forum to which they would otherwise not be entitled.

- B. The parent companies have no standing to litigate the state tax treatment of their domestic subsidiaries absent a showing that they suffer some injury which is truly distinct from, and not merely the indirect result of, injuries to the subsidiaries.

The principle that only a corporation and not its stockholders can complain of an injury or wrong done to the corporation has been honored by the federal judiciary since the early days of its history. See, e.g., *Davenport v. Dows*, 85 U.S. 626 (1874); *Hawes v. Oakland*, 104 U.S. 450 (1882); *Huntington v. Palmer*, 104 U.S. 482 (1882); see also *Forbes v. Memphis*, 9 F. Cases 408 (F. Case No. 4,926) (1872); *Langdon v. Hillside Iron & Coal Co.*, 41 F. 609 (1890).<sup>5</sup> The rule has just as much force today as it ever did. If the cause of action is the corporation's, the corporation is a necessary party, and relief must be sought either directly by the corporation or through a derivative action brought on its behalf. See, e.g., *Ross v. Berhard*, 396 U.S. 531, 538 (1970); *Sax v. World Wide Press*, 809 F. 2d 610, 613-614 (9th Cir. 1987); *Gaff v. Federal Deposit Ins. Corp.*, 814 F. 2d 311, 315, vacated in part, 828 F. 2d 1145 (6th Cir. 1987); *Twohy v. First Nat. Bank of Chicago*, 758 F. 2d 1185, 1194 (7th Cir. 1985).

The rule that a stockholder may not bring suit to redress a corporate injury cannot be avoided by an allegation of injuries to the stockholder which are merely the

<sup>5</sup> Both *Davenport* and *Huntington* involved an action by a stockholder seeking injunctive relief against the assertion of taxes against the corporation in which he held an interest. In *Davenport*, this Court held that a demurrer to the complaint should have been sustained since the corporation itself was not made a party to the suit. In *Huntington*, it held that a demurrer to the complaint had been properly sustained since the stockholder had not satisfied the requirements of a derivative suit.

indirect result of wrongs to the corporation. *Pittsburgh & W. Va. Ry. v. U.S.*, 281 U.S. 479, 486-487 (1930). However, a stockholder may sue to redress direct injuries to himself. Thus, exceptions to the rule are recognized in two situations: (1) where there is a special duty owed to the stockholder personally, "as where the action is based on a contract to which he is a party, or on a right belonging severally to him, or on a fraud affecting him directly;" and (2) where the stockholder suffers an injury separate and distinct from any injury suffered by other stockholders or the corporation itself. 12B W. Fletcher, *Cyclopedia on the Law of Corporations*, § 5911 (Rev. Perm. ed. 1984) (footnotes omitted).

"In cases of the first sort, the complaining shareholder may sue as an individual only because he stands, and has been injured in his relationship to the corporation, in a capacity other than that of a shareholder." *Cowin v. Bresler*, 741 F. 2d 410, 415 (D.C. Cir. 1984). Illustrative decisions applying this exception include *Sedco International, S.A. v. Cory*, 522 F. Supp. 254 (S.D. Iowa 1981), aff'd, 683 F. 2d 1201 (8th Cir. 1982), cert. den., 459 U.S. 1017 (1982) (stockholder injured in his capacity as creditor of corporation); *Empire Life Insurance Co. v. Valdak Corp.*, 468 F. 2d 330 (5th Cir. 1972) (stockholder injured as pledgor in loan transaction); *Davis v. United States Gypsum Co.*, 451 F. 2d 659 (3rd Cir. 1971) (stockholder injured as guarantor of corporate notes). The exception "does not arise merely because the acts complained of resulted in damage both to the corporation and to the stockholder, but is confined to cases where the wrong itself amounts to a breach of duty owed to the stockholder personally." *Schaffer v. Universal Rundle Corporation*, 397 F. 2d 893, 896 (5th Cir. 1968).

Under the second exception to the stockholder standing rule, an individual action may be brought where wrongs are inflicted upon a stockholder alone or upon certain stockholders and not the corporation. *Cowin v. Bresler*, *supra*, at 415. As noted in *Cowin*, this type of case is illustrated by a suit complaining of wrongful withholding of dividends. "Because dividends are an incident of stock ownership, an action to compel the payment of dividends withheld will not inure to the benefit of the corporation; the shareholders alone will gain by a judgment in their favor and, therefore, each shareholder may sue for his own account." *Ibid*. See also *American Power & Light Co. v. S.E.C.*, 325 U.S. 385, 388-391 (1945) (sole stockholder was "person aggrieved" by an order of the Securities and Exchange Commission requiring that an item in the corporation's surplus account be transferred to another account where the item would be unavailable for the payment of dividends).

It is clear that, for either exception to apply, there must be an invasion of some independent right held by the stockholder. The alleged harm must be direct, not indirect. Cf., *Associated General Contractors v. Carpenters*, 459 U.S. 519 (1983) (holding that a labor union was not a "person . . . injured" within the meaning of section 4 of the Clayton Act since any injuries to the union were only the indirect result of injuries to third parties); see, in particular, n. 25 and accompanying discussion on common law damages. Accordingly, it is well settled that a stockholder may not bring an individual action to redress corporate grievances even though he may be economically affected by a wrong to the corporation. See *Pittsburgh & W. Va. Ry. v. U.S.*, *supra*; see also *Sax v. World Wide*

*Press, Inc.*, *supra* (loss of interest income on stock investment); *Gaff v. Federal Deposit Ins. Corp.*, *supra* (diminution in value of stock); *Rand v. Anaconda-Ericsson, Inc.*, 794 F.2d 843 (2d Cir. 1986), cert. den., 479 U.S. 987 (1986) (same); *Warren v. Manufacturers National Bank of Detroit*, 759 F.2d 542 (6th Cir. 1985) (same); *Erlich v. Glasner*, 418 F.2d 226 (9th Cir. 1969) (injuries to business and "right and ability to earn a livelihood"); *Schaffer v. Universal Rundle Corporation*, *supra* (damage to "good will and reputation" of sole stockholder).

On three previous occasions, these principles have been applied in actions brought by a foreign company to challenge California's tax treatment of its domestic subsidiary, and in each case it was held that the foreign company lacked requisite standing because any injuries to that company were merely the indirect result of actions taken against the subsidiary. See *Shell Petroleum, N.V. v. Graves*, 709 F.2d 593 (9th Cir. 1983), cert. den., 464 U.S. 1012 (1983); *EMI Ltd. v. Bennett*, 738 F.2d 994 (9th Cir. 1984), cert. den., 469 U.S. 1073 (1984); *Alcan Aluminum Ltd. v. Franchise Tax Board*, 558 F.Supp. 624 (S.D.N.Y. 1983), aff'd mem., 742 F.2d 1430 (2d Cir. 1983), cert. den., 464 U.S. 1041 (1984). Aside from certain treaty-based claims made in *Shell* and *EMI*, the alleged injuries in each of these cases were substantially identical to those alleged by Alcan and Imperial in the present cases. Indeed, one of the previous cases was an unsuccessful attempt by Alcan to obtain the same relief against the Board that it now seeks in the federal court in Illinois.<sup>6</sup>

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<sup>6</sup> The Board raised the issue of collateral estoppel before the District Court in Illinois, but that issue was never reached by the court, which dismissed Alcan's action on standing grounds. Consequently, the Board did not address the issue of collateral estoppel in the appeal before the Seventh Circuit.

C. The Court of Appeals has given no valid basis for concluding that the parent companies suffer direct injuries that are independent of those to the corporate taxpayers.

1. The Court of Appeals erroneously concluded that the unitary method of taxation burdens the decision-making of foreign companies.

Alcan and Imperial argued in the courts below that the requirement of a direct and independent injury was satisfied by their allegations that the application of California's unitary method of taxation to their domestic subsidiaries results in double taxation of the parents' income (as well as other income in which the parents have an interest) and requires the parents to bear substantial compliance costs. As previously noted, the Court of Appeals did not accept these arguments. It did, however, discover another purported "injury" that was not even suggested by respondents: a burden on the foreign companies' decisions to conduct business through American subsidiaries due to the unitary method's potential "to penalize foreign ownership of American assets." Pet. App., at 15.<sup>7</sup>

The Court of Appeals said that foreign companies seeking to sell or purchase products or services in California choose between conducting business through dealings with American subsidiaries or through contracts

<sup>7</sup> Not only did the respondents fail to raise this argument, but Alcan suggested the reverse: that the unitary method "as applied to foreign parents [sic] has penalized *foreign* activities which increase productivity or develop cheap and abundant resources." Brief of Appellant (Alcan Aluminium Ltd.), at 36; emphasis added.

with unrelated companies.<sup>8</sup> It then appeared to reason that when such companies choose to operate through American subsidiaries, and they conduct foreign business operations at less cost than in California, a higher proportion of the unitary business' worldwide earnings will be attributed to California than would be the case if the foreign companies engaged in precisely the same foreign commerce in California through arm's length contracts with unaffiliated companies. Pet. App., at A15-16. It follows, the court concluded, that the unitary tax diminishes the attractiveness of owning American subsidiaries in comparison with entering into contracts with independent companies, creating a burden on foreign companies' decisions to conduct business through American subsidiaries.

The reasoning of the Court of Appeals contains two major flaws. First, the Court of Appeals has erroneously assumed that if a foreign company were to do business in California through "arm's length contracts with unaffiliated companies," it would have taxable income determinable on a separate accounting basis rather than under the unitary method.<sup>9</sup> On the contrary, in the unlikely event

<sup>8</sup> The court overlooked the fact that foreign companies desiring to conduct business in the United States have a third choice: the conduct of business through branch operations. See, e.g., *Bass, etc., Ltd. v. Tax Comm.*, 266 U.S. 271 (1924) (upholding use of formula apportionment to determine locally taxable income of United Kingdom corporation with branch operations in New York).

<sup>9</sup> The Court of Appeals speaks in terms of the unitary method attributing to California a higher "proportion . . . of worldwide earnings" than would be attributed to California if

(Continued on following page)

that a foreign company were to operate in California through an unaffiliated corporation in such a way as to incur *any* tax liability, that liability would be determined under the unitary apportionment method.<sup>10</sup> If, instead, the foreign company chose to operate in California through a branch of its own corporation, the taxable income of the foreign company would also be determined

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a foreign company conducted its commerce through unaffiliated companies. Thus, the court is clearly under the impression that *some* taxable income of the worldwide unitary business, as opposed to a zero amount of income, would be attributed to the state even in the latter instance. In fact, whether the parent dealt directly with the unaffiliated company or had its American subsidiary do so, if only the unaffiliated company and not the parent or its subsidiary were doing any business in California, California would attribute *none* of the worldwide unitary business income to California since neither parent nor subsidiary would be a California taxpayer under these circumstances.

<sup>10</sup> In its reply to the Board's petition for rehearing in the Court of Appeals, Alcan took this to mean that the Board asserts "it can combine for unitary purposes two companies that are unaffiliated and are dealing at arms [sic] length." Reply to Petition for Rehearing (Alcan Aluminium Limited), at 1-2. That, of course, is incorrect. The point is simply this: If a foreign company engaged in a unitary enterprise were doing business in California through an unaffiliated company in such a manner as to give rise to *any* tax liability on the part of the foreign company, the unitary character of the business would require that the foreign company's tax liability be determined on a formula apportionment basis. This would entail a combined report of only the operations carried on by the *unitary* enterprise within and without the state, not a combined report of the unitary operations and the independent operations of the unaffiliated company.

under the unitary apportionment method. And, finally, if the foreign company were to operate through an American subsidiary, the taxable income of that subsidiary would be determined under the unitary apportionment method. Given these circumstances, the unitary method cannot be viewed as a burden on the foreign company's decision to conduct foreign commerce in one form or another. The unitary method would be used to determine taxable income attributable to California regardless of the form chosen.

In holding that respondents have requisite standing in this matter, the Court of Appeals has also assumed that foreign companies such as Alcan and Imperial have the option of conducting "precisely the same foreign commerce" through either American subsidiaries or independent contractors. This is difficult to imagine. California has not been a mere marketplace for the goods produced by the multinational enterprises headed by Alcan and Imperial. The principal activity of Alcan's subsidiary in California during all but one of the 14 years covered by the challenged tax assessments (1965-1978) consisted of the operation of a large manufacturing facility. JA 66-67. Similarly, Imperial's subsidiary operates manufacturing and research facilities in California. JA 42-43. It is inconceivable that either Alcan or Imperial could conduct "precisely the same foreign commerce" through unaffiliated companies.

Once again, therefore, it is unrealistic for the Court of Appeals to conclude that California's use of the unitary method of taxation in the present matter "diminishes the attractiveness of owning American subsidiaries in comparison with entering into contracts with independent companies as a means of engaging in foreign commerce."

Pet. App., at A15. Such a comparative situation does not exist here. In order to participate in the American economy to the extent they do, Alcan and Imperial must operate either through branches or American subsidiaries.<sup>11</sup> What they insist, however, is that the income attributed to the California segment of the unitary business be determined under the separate accounting/arm's length method of taxation. They have pitted this accounting method against the unitary method, not the use of American subsidiaries against the use of independent contractors.

2. Even if the foreign parents were faced with the choice envisioned by the Court of Appeals, such a "burden" on their decision-making would not constitute a cognizable injury for standing purposes.

As indicated above, the Court of Appeals has apparently assumed that if a foreign company which is part of a unitary business were to engage in commerce in California through contracts with an unaffiliated company, at least some of the income of the unitary business would be attributed to California. Thus, the Court has not gone so far as to suggest that since a foreign company might be able to devise a way to conduct its foreign commerce through an unaffiliated company totally free of California taxes, the imposition of *any* tax against its American

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<sup>11</sup> This was explicitly recognized by Imperial in its opening brief in the Court of Appeals, in which it stated: "Without the existence of Americas, Imperial's considerable commerce with the United States could not exist." Brief of Plaintiff-Appellant Imperial Chemical Industries PLC, at 21.

subsidiary is such a burden on a foreign company's decision-making as give that company standing to challenge *any* California tax in the federal courts. It has stopped just short of that, however.

In effect the Court of Appeals has held that, everything else being equal, a foreign company should not be faced with a state tax law which would tend to discourage the selection of one form of doing business over another. In other words, its underlying thesis seems to be that the potential tax liability arising from the conduct of foreign commerce should be the same regardless of the form in which the commerce is conducted. It is a fact of life, however, that tax consequences often vary, depending upon the form of doing business, the form of a particular business transaction, etc.

It is difficult to understand how the resulting "burden" on a company's decision-making can be regarded as a cognizable injury. In the present case, for example, how are the parent companies truly injured if, as assumed by the Court of Appeals, they can conduct "precisely the same foreign commerce" through either American subsidiaries or independent contractors? They are entirely free to select the alternative which, in their view, will have the most favorable tax consequences. It is illogical to conclude that they suffer a cognizable injury simply because they are put to a choice and may *prefer* to do business in a different form.

In concluding otherwise, the Court of Appeals has also failed to consider the ramifications of its holding that a burden on foreign companies' decision-making will suffice for standing purposes. If indeed such a burden constitutes a cognizable injury, then presumably the injury is at its peak during the decision-making process.

This, in turn, suggests that a foreign company would have standing to challenge the taxing procedures of a state before it ever extended its commerce to that state, i.e., before it made the crucial decision to conduct such commerce through an independent contractor, a branch operation, or a domestic subsidiary. This raises the specter of state taxes being challenged in federal courts not only by nontaxpayers, but by nontaxpayers having no relationship at all, either direct or indirect, with the taxing state.

Finally, in holding that California's method of taxation has somehow burdened the decision-making of Alcan and Imperial (after the barn door has been closed, so to speak), the Court of Appeals has improperly focused on the merits of the constitutional claims they seek to litigate. A principal contention of respondents on the merits of the controversy is that, when applied to domestic corporations with foreign parents, California's unitary method of taxation violates the "one voice" standard set forth in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1978). In particular, they have pointed to foreign objections to this method of taxation and to the possibility of foreign retaliation. The Court of Appeals has confused these constitutional claims with the essential question of standing: whether the parent-stockholders, or the corporate taxpayers, are the proper parties to litigate the constitutional claims.

The Court of Appeals has stated, for example, that "[t]o the extent that California's franchise tax burdens foreign companies' decisions to conduct business through subsidiaries operating in California, it threatens to offend this country's trading partners. . . ." Pet. App., at A16. It has also stated that "It is important that these injuries [to

Alcan and Imperial] . . . have fueled a simmering trade controversy which has raised concerns about foreign retaliation and the country's ability to speak with one voice on matters of foreign commerce. . . ." *Id.*, at A17. And at footnote 10 of its opinion, the Court has reasoned that the unitary method "implicates . . . concerns about foreign retaliation" because it "has the potential to shift a higher proportion of the corporate tax burden onto companies that are affiliated with foreign operations."<sup>12</sup> It continues:

"Evaluation of the constitutional significance of this threat in the particular circumstances presented by California's unitary tax must await the district court's assessment of the merits of this appeal. We decide only that the potential for constitutionally significant offense is sufficient to create standing." *Id.*, at A16; emphasis added.

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<sup>12</sup> This potential also exists, of course, in the case of a multinational enterprise headed by a domestic company. It is also unclear what the Court of Appeals means by its statement that, "The potential for the unitary tax to penalize foreign ownership of American assets distinguishes the unitary tax from environment or safety regulations that might cause comparable increases in the cost of doing business in California, but would presumably affect foreign and domestically owned operations fairly equally." Pet. App., at A15. California's tax treatment of foreign and domestically owned operations is the same. Furthermore, assuming *arguendo* that a foreign company could reduce the cost of doing business in California by choosing to operate solely through independent contractors, thus eliminating the use of foreign factors in California's tax computations, exactly the same choice (or in the Court's analysis, exactly the same burden) would be available to domestic parents engaged in foreign commerce by means of a worldwide unitary business.

The Court of Appeals has held, in short, that since there may be some merit to the Foreign Commerce Clause claims made by Alcan and Imperial, they have the standing to litigate those claims. This Court has repeatedly observed, however, that "standing in no way depends on the merits of the plaintiff's contention that particular conduct is illegal. . . ." *Warth v. Seldin*, 422 U.S. 490, 500 (1975); see also *Flast v. Cohen*, 392 U.S. 83, 99 (1968); *Simon v. Eastern Ky. Welfare Rights Organization*, 426 U.S. 26, 37-38 (1976); *Valley Forge College v. Americans United*, 454 U.S. 464, 476 (1982).

**3. The purported injury to the parent companies is neither "direct" nor "independent" of their status as corporate stockholders.**

Prudential considerations in general, see, e.g., *Allen v. Wright*, 468 U.S. 737, 751 (1984), and the shareholder standing rule in particular ordinarily prohibit a party from litigating the legal rights of another. The legal right at issue in the present matter is the right of the corporate taxpayers to have their tax liability determined in a lawful manner – i.e., in a manner which does not violate the Foreign Commerce Clause. Whether the constitutional issue is litigated in suits for refund brought by the corporate taxpayers in the state courts, or whether their foreign parents are permitted to litigate the issue in federal court, the issue remains the same: Do the taxes assessed against the corporate taxpayers interfere with Congress' power to regulate foreign commerce? Thus, the standing question essentially is whether the parent companies may challenge the constitutionality of tax assessments issued against taxpayer-subidiaries which are perfectly capable of pursuing the same constitutional claims.

The Court of Appeals has concluded that the foreign parents are injured in such a way as to have standing to litigate their subsidiaries' tax liability. As discussed above, the perceived injury to the parents is tenuous at best. In addition, however, the Court of Appeals has failed to offer any reasoned explanation for treating the perceived injury to the parent companies as either a "direct" injury or as an injury "independent" of their stockholder status.

If the tax liability of a corporate taxpayer is determined in a manner which violates the Foreign Commerce Clause, it seems self-evident that the party *directly* injured by such a tax determination is the corporate taxpayer against which the unlawful taxes are assessed. Conversely, any injuries to a parent-stockholder in such an instance are necessarily *indirect* since they result from the allegedly unlawful taxes assessed against the corporate taxpayer. The Court of Appeals has not explained its logic for concluding otherwise.

The Court does offer some explanation for treating the perceived injury as one not affecting the foreign companies only in their capacity as stockholders, but its explanation is hardly satisfactory. The Court says that the foreign parents not only own the subsidiaries; they own them "as instrumentalities of the foreign commerce of [the] parents." Pet. App., at A15. But why is this a fact of magical proportions? Every wholly-owned subsidiary can be viewed as an instrumentality by which the parent conducts one type of commerce or another – intrastate, interstate or foreign. The fact that a foreign company utilizes an American subsidiary as an instrumentality of foreign commerce should not, therefore, be considered as creating some sort of special relationship between the two for standing purposes.

The decision of the Court of Appeals to the contrary raises, of course, still other questions. How far does its reasoning go? Is federal standing to litigate state tax matters to be accorded only to foreign companies which own American subsidiaries? If so, what is the justification for differential treatment of domestic companies which utilize various subsidiaries as "instrumentalities" of interstate commerce? If federal standing is not to be so limited, will the federal courts be deluged with suits filed by domestic companies which are dissatisfied with the state tax treatment of their subsidiaries? Meanwhile, what happens to the spirit, if not the letter, of the Tax Injunction Act?

**D. The specific claims of independent injury actually asserted by the parent companies in the courts below were properly rejected by the Court of Appeals.**

It has been stipulated in the two cases that (1) all taxes are or will be assessed against the domestic subsidiaries, and (2) all informational requests have been directed only to the domestic subsidiaries. JA 53, 99. Alcan and Imperial nevertheless have claimed that they suffer injuries independent of those to their domestic subsidiaries because they must bear the burdens of double taxation and excessive compliance costs allegedly arising from California's use of formula apportionment in calculating their subsidiaries' taxable income. All of the previous cases which have held that foreign parents lack standing to challenge California's method of taxation as applied to their domestic subsidiaries have considered and rejected identical claims of independent injury. See, *infra*, at 25. The Court of Appeals properly rejected the same claims in the cases at hand.

One aspect of the double taxation argument is the suggestion by Alcan and Imperial that California is actually taxing the income of the foreign parents because their income is taken into account in the apportionment formula. This contention, which is the classic argument against the use of formula apportionment, has, of course, been soundly rejected by this Court on numerous occasions. Addressing a similar claim just last year, the Court stated:

"But income that is included in the preapportioned tax base is not, by virtue of that inclusion, taxed by the State. . . . As our Commerce Clause analysis of apportionment formulas has made clear, the inclusion of income in the preapportioned tax base of a state apportionment formula does not amount to extraterritorial taxation." *Shell Oil Company v. Iowa Dept. of Revenue*, \_\_\_ U.S. \_\_\_, 109 S. Ct. 278, 284, 102 L. Ed. 2d 186, 199 (1988).

The notion that formula apportionment and extraterritorial taxation go hand-in-hand has no greater credibility in the standing context than it has in an attack on the use of formula apportionment generally.

Furthermore, Alcan and Imperial have never explained why the taxes imposed on AlcanCorp and Americas would directly injure the parent companies even if the taxes were *not* measured solely by the subsidiaries' income. The tax assessments have been issued only against the California taxpayers, and only the California taxpayers are held accountable to California. Obviously, if the asserted taxes are measured in part by income earned and taxed elsewhere, it is the corporate taxpayers which must bear the burden of the resulting double taxation. At the most, Alcan and Imperial would be injured only to the extent that the taxes imposed on AlcanCorp and Imperial (double or otherwise) adversely affect the value of the parents' stockholdings in those subsidiaries.

Beyond question, such an injury is insufficient for standing purposes. See, *infra*, at 24-25.

Imperial has sought to bring the claim of double taxation closer to home by also arguing that, because the taxing authorities of the United Kingdom consider the California taxes to be partially measured by income not having a source in California, Imperial cannot take full advantage of a credit allowed under U.K. law. This credit relates to foreign taxes paid on earnings which are the source of dividends paid to a U.K. company. See Imperial Stip., Exh. 19. In the present case, however, no dividends have in fact been paid by Imperial's domestic subsidiary during any of the years in question. *Ibid.* Accordingly, the asserted injury to Imperial is purely hypothetical. Moreover, even if dividends had been paid to the parent company, and even if the U.K. credit had been affected by the California taxes, Imperial still would suffer only an *indirect* injury as a result of the alleged wrongful act of California – namely, California's imposition of an excessive tax upon Imperial's subsidiary. There would be no breach of a duty owed by California to Imperial in such a situation.

The further claim that the foreign parents are forced to bear the burden of compliance costs is also without merit. The parents have not been asked to do anything. Informational requests made by the Board during the audit process have been directed only to AlcanCorp and Americas. No demands have been made on Alcan and Imperial, and clearly both have been at liberty to decline any requests for information which may have been directed to them by their subsidiaries. The situation is the same as that presented in *EMI Ltd. v. Bennett*, *supra*, 738 F. 2d, at 996, where the court stated:

"The FTB is making demands for information only from Capitol. If Capitol fails to produce the information because of EMI's recalcitrance the result will be, at worst, either an increase in Capitol's tax liability or a tax penalty. Whether through the imposition on Capitol of taxes or the increase in taxes because of Capitol's failure to produce information, EMI's only possible injury is the diminution in the value of its holdings in Capitol."

The reasoning of the *EMI* court applies with equal force to respondents' argument that, unless their subsidiaries are to be at the mercy of the California taxing authorities, the parents must establish elaborate systems of accounting to determine the correct California tax liability. What Alcan and Imperial actually are complaining about is the expense of gathering information which *they* deem essential to a fairer calculation of the taxes assessed against their subsidiaries. This again would be an assumed burden undertaken to preserve the value of their stockholdings, not a burden imposed upon them by the taxing authorities.<sup>13</sup>

There remains one further argument advanced by Imperial. Citing *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1978), Imperial has contended, in effect, that a foreign company should have standing to raise constitutional objections to tax assessments against its domestic subsidiary even in the absence of an independent injury.

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<sup>13</sup> The extent to which *any* additional information furnished by the parent companies would substantially alter the amount of taxes assessed is itself subject to dispute. Much of the information utilized in making the assessments against AlcanCorp and Americas is already available in published form. See JA 51-52, 70-71.

It has reasoned that the property tax challenged by the foreign corporation in *Japan Line* was imposed upon the containers, not upon the foreign owner of the containers. By the same token, according to Imperial, it should have standing to challenge the constitutionality of a tax imposed upon its subsidiary, which, like the containers in *Japan Line*, are instrumentalities of foreign commerce. The situation is not, of course, analogous. Obviously, in *Japan Line* the containers themselves were not the taxpayers; the only taxpayer was the foreign owner of the containers. In the present cases, the reverse is true; the tax assessments have been directed to the two domestic subsidiaries, and they, not their foreign owners, are the California taxpayers.<sup>14</sup>

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<sup>14</sup> Imperial has previously asserted that the Board, for purposes other than standing, treats all corporations within the unitary group as one "taxpayer." This is incorrect. The apportionment provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA) are incorporated in the California Revenue and Taxation Code at sections 25120 through 25139. Under California law, these provisions apply both to a unitary business conducted by a single corporation and to a unitary business conducted in multi-corporate form. In some of the apportionment provisions the term "taxpayer" is used to refer to the unitary business as a whole. For example, section 25134 defines the sales factor as "a fraction, the numerator of which is the total sales of the taxpayer in this state, and the denominator of which is the total sales of the taxpayer everywhere during the income year." (Emphasis added.) When this provision is applied to a unitary business conducted by two or more corporations, the term "taxpayer" in the second clause refers to all components of the unitary business, but the same term in the first clause refers only to the entity doing business in California. The franchise tax is imposed only upon the "corporation doing business within the limits of [the] state. . . ." Cal. Rev. & Tax. Code § 23151. Accordingly, only the corporation doing business in California is the California "taxpayer" in the traditional sense of the party actually subject to state taxation.

## ENTERTAINMENT OF THE FEDERAL ACTIONS FILED BY THE PARENT COMPANIES CANNOT BE RECONCILED WITH THE PROSCRIPTIONS OF THE TAX INJUNCTION ACT AND ITS UNDERLYING PRINCIPLE OF COMITY.

### A. Introductory Statement.

In their briefs in opposition to the Board's petition for review of the Court of Appeals' decision, both Alcan and Imperial asserted that the Tax Injunction Act (28 U.S.C. § 1341) does not present a meaningful issue in this matter. The applicability of the Act, on the contrary, is very much an issue even if it should be determined or assumed that Alcan and Imperial otherwise satisfy standing requirements.

Section 1341 provides:

"The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."

It is well established that the statute is an explicit Congressional limitation on the jurisdiction of the federal courts in the area of state taxation. As this Court stated in *Rosewell v. LaSalle National Bank*, 450 U.S. 503, 522 (1981):

"The statute 'has its roots in equity practice, in principles of federalism, and in recognition of the imperative need of a State to administer its own fiscal operations.' *Tully v. Griffin, Inc.*, 429 U.S. (68), at 73. This last consideration was the principal motivating force behind the Act; this legislation was first and foremost a vehicle to limit drastically federal district court jurisdiction to interfere with so important a local concern as the collection of taxes."

Thus, the Tax Injunction Act generally prohibits federal courts from granting injunctive relief in cases involving state tax administration; such relief is permitted only

in exceptional circumstances where the state court remedy is not "plain, speedy and efficient." *Id.*, at 512. The same rule is applied to requests for declaratory relief. *California v. Grace Brethren Church*, 457 U.S. 393, 408 (1982).

The Court of Appeals decided in the present matter that the sole stockholder of a corporation is not barred by the Act from bringing a federal action to challenge state taxes levied against that corporation, even though, as the sole corporate stockholder, it is capable of pursuing its constitutional objections to the taxes through the state remedies afforded to the corporation. As will be explained below, this ruling not only defies reason but is in conflict with past authority.

**B. For purposes of the Tax Injunction Act, the parent companies effectively have alternative state remedies to pursue.**

The Court of Appeals concluded that the Tax Injunction Act is inapplicable to the actions brought by Alcan and Imperial because "the Act has not been construed so broadly as to bar a nontaxpayer . . . who lacks a remedy in state court from bringing suit in federal court on the ground that an affiliated taxpayer possesses adequate state court remedies." Pet. App., at A-18.<sup>15</sup> But while it is

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<sup>15</sup> In support of this proposition, the Court of Appeals cited its earlier decision in *Alcan Aluminium Ltd. v. Dept. of Revenue*, 724 F. 2d 1294 (7th Cir. 1984), which in turn cited *Capitol Indus.-EMI, Inc. v. Bennett*, 681 F. 2d 1107 (9th Cir. 1982), cert. den., 455 U.S. 943 (1982). However, each of the cases relied on in *Capitol* involved a situation where a suit for refund

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true, as the Court of Appeals observed, that California affords remedies only to the taxpaying subsidiaries, it does not automatically follow that Alcan and Imperial are thus deprived of effective state remedies. The two wholly-owned subsidiaries (which are more than "affiliated" taxpayers) unquestionably have adequate remedies in the state courts. See, e.g., *California v. Grace Brethren Church*, *supra*, at 415. And Alcan and Imperial, which have absolute control over their subsidiaries, obviously are in a position to ensure that these remedies are pursued with vigor. In other words, neither of the parent companies was required to bring these lawsuits to ensure a full challenge to the California taxing procedures. As the sole stockholders of their respective subsidiaries, both of the parent companies can litigate the constitutionality of California's method of taxation through the state remedies available to the actual taxpayers. Due to their total control over the actual taxpayers, the parent companies effectively *have* state remedies to pursue.

This Court has recognized, as least by way of dictum, that such practical considerations should govern the determination of whether a nontaxpayer has alternative remedies to seeking injunctive relief against taxing authorities. In *South Carolina v. Regan*, 465 U.S. 369 (1984), the State of South Carolina sought to challenge an

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(Continued from previous page)

was unavailable or inadequate because the taxing agency sought to collect the taxes from a person other than the original taxpayer. The *Capitol* court did not consider the argument advanced here that such a suit for refund constitutes an adequate remedy for a nontaxpayer who is the sole stockholder of the corporation against which the taxes are asserted.

amendment to section 103 of the Internal Revenue Code which placed restrictions on the types of state bonds otherwise qualifying for the exemption granted by that section. The case thus raised an issue as to the applicability of the Anti-Injunction Act (26 U.S.C. § 7421(a)), which, in language analogous to that contained in the Tax Injunction Act, bars a suit "for the purpose of restraining the assessment or collection of any [federal] tax."<sup>16</sup> The Court held that the State's suit was not barred by the Anti-Injunction Act because South Carolina had no other remedy and "the Act was intended to apply only when Congress has provided an alternative avenue for an aggrieved party to litigate its claims on its own behalf." 465 U.S., at 381. In a concurring opinion, Justice O'Connor questioned the breadth of the holding, suggesting that it would enable taxpayers to evade the Anti-Injunction Act by forming organizations to litigate their tax claims. *Id.*, at 386, 394. The majority gave assurances to the contrary, stating:

"Because taxpayers have alternative remedies, it would elevate form over substance to treat such organizations as if they did not possess alternative remedies. Accordingly, such organizations could not successfully argue that the Act does not apply because they are without alternative remedies." *Id.*, at 381, n. 19.

<sup>16</sup> In 1966 Congress added an explicit statement to the Anti-Injunction Act which clarified that the bar pertained to suits "by any person, whether or not such person is the person against whom such tax was assessed." This Court has recognized that "[t]he 'by any person' phrase is . . . a reaffirmation of the plain meaning of . . . § 7421(a)" as it had existed prior to the 1966 amendment. *Bob Jones University v. Simon*, 416 U.S. 725, 731-732, n. 6 (1974); see also *South Carolina v. Regan*, *supra*, at 377-378, n. 16.

Similarly, for purposes of the Tax Injunction Act, it would elevate form over substance to treat the parent company of a wholly-owned subsidiary as lacking an alternative state remedy when the subsidiary itself has such a remedy.

The Court also emphasized in *Regan* that, in the absence of injunctive relief under the facts of that case, the "aggrieved party would be required to depend on the mere possibility of persuading a third party to assert [its] claims." *Id.*, at 381. Plainly that is not the situation here. The parent company of a wholly-owned subsidiary is not in the helpless position of being "required to depend on the mere possibility of persuading [its subsidiary] to assert [the parent's] claims." Its total control over the actual taxpayer gives the parent the power to determine precisely when, where and how the taxpayer is to pursue any constitutional objections to the asserted taxes.

The use of a shareholder's suit to avoid proscriptions against injunctive relief is, in fact, a time-dishonored device. As described in Professor Moore's treatise on federal practice, over a number of years following the enactment of the Anti-Injunction Act,

"[t]he courts . . . carved out many exceptions, so that at one time much of the evil the [Act] was aimed at again became prevalent. But in order to lessen the hazard of having a court decide that a suit for an injunction to restrain the collection of a federal tax was within the [A]ct, and therefore dismiss the bill, the technique of having a shareholder sue the corporation and seek an injunction restraining it from paying the tax was evolved." 3B *Moore's Federal Practice* ¶ 23.1.16[2], at 23.1-52; emphasis in original.

This technique met with early success, but came under increasing criticism. Finally, some 50 years ago, in *Norman*

*v. Consolidated Edison Co. of New York*, 89 F. 2d 619 (2d Cir. 1937) one distinguished federal panel called a halt.

The plaintiff-stockholder in *Consolidated Edison* brought suit to enjoin the corporation from paying taxes imposed under title 8 of the Social Security Act. The court upheld a dismissal of the suit on the ground that the corporation itself had an adequate remedy at law in the form of a suit for refund and that the suit by the stockholder clearly was an attempt to avoid indirectly the prohibition of the Anti-Injunction Act. The court, in an opinion written by Judge Augustus Hand, stated:

"Clearly the corporation itself could not successfully maintain a suit to enjoin collection of the taxes because of the prohibition of such suits by R.S. § 3224 (26 U.S.C.A. § 1543); but it may pay the taxes and sue to recover them back whenever the question as to the validity of the Social Security Act is determined. In the meantime there is no reason for allowing the statutory prohibition against enjoining the collection of taxes to be whittled away through the use of a stockholder's bill that makes no better showing of irreparable damage than does the one here. To sanction such a device might well result in a widespread interference with the collection of government revenues.

"The plaintiff has suffered no irreparable damage to his stock interest, since his corporation has an adequate remedy at law for recovering any taxes that may turn out to be unlawful exactions. . . ." 89 F. 2d, at 624.

Later in the same year, when another stockholder's suit challenging the validity of the Social Security Act reached this Court, four of the Justices preferred to dismiss it on the authority of *Consolidated Edison*. See *Helvering v. Davis*, 301 U.S. 619, 639 (1937). However, a majority of the Court agreed that the matter could proceed on the

merits, evidently because the federal government, anxious for a decision, had "waived" the Anti-Injunction Act. No such extenuating circumstances exist here. In any case, whether particular litigation involves injunctive relief proscribed by the Anti-Injunction Act, the Johnson Act of 1934 (28 U.S.C. § 1342), or the Tax Injunction Act, it is difficult to quarrel with Professor Moore's observation that the use of a shareholder's action "in any of these fields for the purpose of circumventing the statutory policy is unsound." 3B *Moore's Federal Practice* ¶ 23.1.16[2], at 23.1-53.

**C. Respondents' domestic subsidiaries are entitled to raise the same constitutional claims as the parent companies.**

Circumvention of the Tax Injunction Act is the only apparent objective of the present suits brought in the names of the stockholder-parents rather than in the names of the taxpayer-subsidaries.<sup>17</sup> It is disingenuous for Alcan and Imperial to claim, as they have repeatedly, that the parent companies have distinct rights under the Foreign Commerce Clause and thus must be given a forum in which to vindicate their "own" rights. As this Court has said with respect to the interstate aspects of the Commerce Clause: "The Clause protects the interstate market, not particular interstate firms, from prohibited or burdensome regulations." *Exxon Corp. v. Governor of*

<sup>17</sup> The artificiality of permitting a federal action to be pursued in the name of the parent company under such circumstances is dramatically illustrated here. In each of the cases, the chief spokesman for the parent company in the federal litigation has been the house counsel for the taxpayer-subsidary.

*Maryland*, 437 U.S. 117, 127-128 (1978). Stated another way, "the Commerce Clause deals with the relationship between national and state interests . . . not with the protection of individual rights." *J & J Anderson, Inc. v. Town of Erie*, 767 F. 2d 1469, 1476 (10th Cir. 1985); see also *Consol. Freightways Corp. of Del. v. Kassel*, 730 F. 2d 1139, 1144-1145 (1984).<sup>18</sup>

It follows from the above line of authority that any constitutional objections the parent companies may have to California's method of taxation are shared with the taxpayer-subsidaries. It also follows that the taxpayer-subsidaries would be able to argue in the state courts that the alleged burdens imposed on their foreign parents are of such a nature as to interfere with the congressional power to regulate foreign commerce. The tax assessments issued against the domestic subsidiaries are invalid under the Commerce Clause if they interfere with the regulatory power of Congress. Consequently, it only makes sense that the subsidiaries, as the parties directly concerned, would be entitled to complain of *any* burdens which interfere with the congressional power and hence render the tax assessments against the subsidiaries invalid. In short, it is totally illogical to assert that a corporate taxpayer is powerless to raise constitutional objections to a tax which *it* is required to pay.

<sup>18</sup> In both *Anderson* and *Consol. Freightways*, plaintiffs sought attorney's fees under 42 U.S.C. §§ 1983 and 1988 after challenging certain state regulations on Commerce Clause grounds. The courts held that the Commerce Clause does not secure "rights" within the meaning of § 1983. The cases demonstrate that although a party may have standing to complain of a Commerce Clause violation, this does not mean that he holds individual "rights" under that clause.

- D. If the literal terms of the Tax Injunction Act do not apply, the parents' actions nevertheless should be dismissed on the basis of the principle of comity underlying the Act.**

It is clear that the purposes of the Tax Injunction Act are frustrated if it is read as permitting a sole stockholder to challenge a state tax assessment in federal court when the corporate taxpayer directly concerned is barred from doing so. Accordingly, if the literal language of the Act is not sufficient to prohibit the federal relief sought by Alcan and Imperial, their actions should be dismissed on the basis of the principle of comity which underlies the Act. See, e.g., *Fair Assessment in Real Estate v. McNary*, 454 U.S. 100 (1981). The deference heretofore given to the administration of state taxes cannot be so flimsy in character as to permit federal intrusion in state tax matters simply because a federal action is brought in the name of a sole stockholder rather than the corporate taxpayer.

The Court of Appeals reached the opposite conclusion, attaching significance to what it termed California's "effective means of self-help." Pet. App., at A20. The court stated that,

"California presumably possesses a ready remedy for unwanted federal intrusion. To eliminate federal court jurisdiction over disputes of this nature, the state need only provide foreign parent companies with a 'plain, speedy and efficient' remedy of their own in state court." *Ibid.*

The theoretical justification for providing such a remedy, apart from the coercive effect of "unwanted federal intrusion," is unclear. Moreover, the cure suggested by the Court of Appeals would likely be as disruptive of the administration of state taxes as is a federal suit seeking

injunctive relief against state tax authorities. Such disruption of state tax administration is as unnecessary as it is undesirable, for here the foreign parent companies have their own "effective means of self-help:" the total control they can exercise to direct their subsidiaries' fully adequate California remedies for testing the validity of California's tax assessments.

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### CONCLUSION

The judgment of the Court of Appeals reversing the dismissal of the actions filed by Alcan and Imperial should be reversed.

DATED: June 8, 1989

Respectfully submitted,

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County Clerk of the State of California,  
do hereby certify that the within and foregoing is a true and correct copy of the  
Petitioners,

ALCAN ALUMINUM LIMITED AND  
NATIONAL CHEMICAL INDUSTRIES PLC.

Respondents.

Case No. 03-2-00000-000000-000000  
Case Of and Against The United States  
Court Of Appeals For The Seventh Circuit

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## QUESTIONS PRESENTED

Did the Seventh Circuit Court of Appeals err in holding that the Worldwide Method of Combined Apportionment ("WCA") imposed on the unitary business headed by the Respondent resulted in a direct burden on its foreign commerce, thus Respondent had standing to challenge the constitutionality of the tax?

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## STATEMENT OF THE CASE

## I. PROCEDURAL CONTEXT

This action was brought on August 10, 1984 (Joint Appendix ["JA"], at 6-12) by Alcan Aluminium Limited ("Respondent") seeking a declaratory judgment declaring that the imposition of Worldwide Method of Combined Apportionment ("WCA") upon the unitary business of which it was the parent was in violation of the Foreign Commerce Clause of the United States Constitution; and seeking an injunction against the Franchise Tax Board of the State of California and the individually named defendants (hereinafter jointly referred to as the "Petitioners" or "FTB"). The Petitioners responded with a motion to dismiss on three grounds: collateral estoppel, abstention and lack of standing (JA at 13-15). On January 10, 1985, Judge Prentice Marshall denied all the Petitioners' motions (JA at 26-29). Subsequently, the case was assigned to Judge Ann C. Williams. The parties prepared comprehensive stipulated facts and submitted to Judge Williams on cross-motions for summary judgment pursuant to Rule 56 the issue of whether there was an unconstitutional burden. As part of its motion, the Petitioners asked Judge Williams to reconsider Judge Marshall's ruling that Respondents' allegation of an unconstitutional burden on its foreign commerce gives rise to standing. Judge Williams did reconsider, reversed the decision of Judge Marshall, and dismissed Respondents' complaint for lack of standing (Petition for Writ at A-21 to A-27). Respondent appealed Judge Williams' dismissal. The Seventh Circuit unanimously reversed the District Court (*Id.* at A-1 to A-21). That reversal is the subject of the present appeal to this Court.

## II. FACTUAL CONTEXT

Respondent, Alcan Aluminium Limited, is a corporation organized and existing under the laws of Canada. Its headquarters and principal place of business are in Mon-

treal, Quebec (Stipulation #2 [hereinafter "Stip."] JA at 64). Respondent and various of its subsidiaries are engaged in all phases of the aluminum business on an international scale. Respondent and nearly one hundred of its subsidiaries operate in several different countries – all wholly outside the United States (Stip. #4, JA at 64). Neither Respondent nor any of its non-United States subsidiaries has a permanent establishment in the United States (Stip. #6, JA at 65).

Respondent indirectly owns all of the issued stock of Alcan Aluminum Corporation (hereinafter "Alcancorp").<sup>1</sup> Alcancorp is a corporation organized and existing under the laws of the State of Ohio; its principal place of business is at Cleveland, Ohio (Stip. #7, JA at 65). Alcancorp and its subsidiaries are engaged in the business of fabricating and selling various aluminum products in the United States (Stip. #10, JA at 66-67). Certain of the activities of Alcancorp are conducted in the State of California (Stip. #10, JA at 66-67).

The Petitioners in this case are the Franchise Tax Board of the State of California, operating through its permanent office in Chicago, Illinois (hereinafter the "FTB"), Leonard Wilson, District Manager of the Chicago Office of the FTB, and B. M. Rarang, Auditor of the Chicago office of the FTB (Stip. #12-16, JA at 67-68). Petitioners have the power and duty to administer the Bank and Corporation Tax Law of the State of California, the California Revenue and Taxation Code, and other California provisions relating to taxation (hereinafter "California tax laws") (Stip. #15, JA at 68).

<sup>1</sup> The direct owner of Alcancorp is also a foreign corporation – Aluminium Company of Canada, Ltd. (Stip. #17, JA at 68-69). Since Stip. #17, a corporate reorganization has occurred. The Aluminium Company of Canada, Limited has changed its name to Alcan Aluminium Holdings Limited and has become a subsidiary of the new Alcan Aluminium Limited. This reorganization in no way affects the tax, its computation or the substance of this litigation.

Petitioners assess franchise taxes on companies doing business in the State of California on what is known as a "unitary" basis. Under this method of taxation, the income of the unitary business "attributable" to California is calculated by a formula which multiplies the total income of the unitary business by the relative percentage of that business's property, payroll and sales in California (Stip. #20-22, JA at 70-71).

Since 1965, the Petitioners have collected detailed financial information on the business and operations of Alcancorp. Petitioners have measured and assessed California franchise taxes not solely on the income of Alcancorp, but also on the worldwide income of Respondent (Alcancorp's indirect parent), and all of Respondent's non-United States subsidiaries (the "Alcan Unitary Business"). Petitioners Wilson and Rarang, acting under color of their authority under state law, have management and supervisory responsibility for these actions of the Chicago Office of the Tax Board (Stip. #16, JA at 68).

The purpose and effect of Petitioners' actions is to inflate greatly<sup>2</sup> the amount of tax assessed and collected by attributing to California a portion of the worldwide income of Respondent and its non-United States subsidiaries.<sup>3</sup> Respondent and its non-United States subsidiaries, however, have no permanent place of business in the United States and, in fact, the activities of Respondent and its non-United States subsidiaries are all taxed by the host country in which those activities take place and in Canada upon distribution (Stip. #42, JA at 85). Thus, the

<sup>2</sup> The tax has in some cases increased the California tax liability by an infinite factor! See pp. 30-31, *infra*.

<sup>3</sup> Rather than applying this concept of taxation to attribute to California income earned elsewhere by Alcancorp and its subsidiaries, Petitioners are using it to attribute to California income earned *upstream* by Alcancorp's parent corporation and its subsidiaries. This is a significant economic distinction between the foreign parent situation and the application of WCA in the U.S. parent situation.

method of taxation used by Petitioners taxes this income multiple times. More importantly, it effectively taxes Respondent's foreign operations. The net economic impact is to ignore the fact that Respondent is operating in the United States through a subsidiary and to treat it as though it was operating directly. Respondent, as a foreign corporation, alleges that Petitioners' application of unitary income taxation in such a manner violates the Foreign Commerce and Supremacy Clauses of the United States Constitution.

In this case, the Petitioners have, in fact, stipulated to facts which establish these allegations as true. Thus, both the District Court and the Seventh Circuit Court of Appeals had before it the full body of facts supporting the allegations. The existence of a direct burden on Respondent's foreign activities is beyond dispute and so, equally, is Petitioners' standing to seek a judicial remedy.

### SUMMARY OF ARGUMENT

Respondent's claim to standing is predicated on traditional legal doctrine. WCA injures it directly by effectively eliminating the insulating character one would expect in the role of a shareholder.

Respondent's fundamental thesis is that it is impossible to resolve the standing issue against it without simultaneously resolving the constitutional issue to its detriment. Both the Seventh and the Second Circuit necessarily resolved the constitutional issue in the course of resolving Respondent's standing. The Ninth Circuit artificially attempted to resolve the standing issue as one of pure procedure, and that resulted in its contradicting its logic in prior decisions.

The Petitioners attempt to demonstrate that WCA creates no burden on foreign commerce is plagued with inconsistent contradiction. It is clear that no consistent reasoning can lead one to the conclusion that the WCA's effective elimination of the subsidiary as a vehicle for

conducting foreign commerce is a benefit to anyone other than the Respondent.

Finally, it is well recognized that under every standard articulated by this Court, the public statements of respected national officials and common sense economics, WCA constitutes an impermissible burden on Respondent's conduct of its foreign commerce. Since it has suffered a direct injury, Respondent is entitled to standing and to a determination that WCA is constitutionally proscribed.

### ARGUMENT

#### I. CONTRARY TO THE ASSERTION BY THE PETITIONER, THE DECISION OF THE SEVENTH CIRCUIT IS PREDICATED ON TRADITIONAL NOTIONS OF STANDING

It is a well established principle that shareholders may not bring an action in their own name when that action derives solely and exclusively from an injury to the corporation in which they own stock. This principle derives from the long-standing and well recognized principle that a corporation is a separate and distinct legal entity from its shareholder. *Hawes v. Oakland*, 104 U.S. 450 (1881). The concept that a corporation is a legal person is *sine quo non* for the corporation. It is this concept that, except in the most unusual circumstances, insulates the shareholder from personal liability for the actions of the corporation. The corollary to limitation of liability for the shareholder is that the shareholder has no direct cause of action for injuries to the corporation; it must sue derivatively.

An equally, well established principle is that a shareholder is not deprived of a personal right of action simply because of his shareholder status. This principle is described by the Petitioners in their brief on page 23:

"In cases of the first sort, the complaining shareholder may sue as an individual only because he

stands, and has been injured in his relationship to the corporation, in a capacity other than that of a shareholder."

Petitioners' Brief on the Merits, p. 23 ("Petitioners' Brief"). It is this well established principle which is the basis for this case.

Petitioners attempt to distinguish this case by suggesting that the Respondent is merely complaining about injuries to its U.S. subsidiary. Nothing could be further from the truth. This case involves a direct injury to the Respondent; it results from a direct breach of duty to the Respondent. Moreover, conceding such a proposition would obviate Respondent's constitutional challenge to WCA.

#### A. PETITIONERS HAVE CONTINUOUSLY REPRESENTED THE UNITARY METHOD OF TAXATION AS A DIRECT TAX ON RESPONDENT

Petitioners and their Amici have attempted to recharacterize WCA as a tax exclusively imposed on the American subsidiary. Their most recent attempt at this recharacterization is the Petitioners' use of this Court's dictum which stated that the unitary method of taxation did not result in taxation of extra territorial income to support the proposition that there can be no double taxation of Respondent by WCA and, therefore, no direct injury. See *Shell Oil Company v. Iowa Dept. of Revenue*, \_\_\_ U.S. \_\_\_, 109 S.Ct. 278, 102 L.Ed. 2d 186 (1988). This Court's comment was clearly intended to make a different point involving the statutory interpretation of territorial limitations in the federal statute regulating offshore drilling. That point was that using the unitary method in the context allocating income of a single company among the states, was *not the same as* assessing a tax on entities physically located in the jurisdiction. Clearly, this Court's comments in *Shell* were not intended to change its explicit holding in *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983), that WCA can and does result in extraterritorial double taxation.

In fact, there is little doubt that WCA is directly imposed upon the Respondent, and it is this fact that gives rise to standing. Petitioners in this case and in prior cases place this fact beyond dispute in their own characterizations of the tax.

Unitary taxation starts with the proposition that the nature of a unitary business is such that it is impossible to identify the source of profits, i.e., "the profit is derived from the operation of the business as a whole." (Def. Brief, *Alcan Aluminum Ltd. v. Franchise Tax Board of California*, 558 F.Supp. 624 [S.D.N.Y. 1983] [hereinafter "*Alcan I*"], p. 4, Exhibit A) The unitary business can be composed of one corporation or of "many related corporations." (Def. Brief, *Alcan I*, p. 3) In *Alcan I*, the Petitioners stated that Respondent and AlcanCorp are a unitary business and that the business "spreads beyond California and national boundaries." (Def. Brief, *Alcan I*, p.3) Consequently, conclude Petitioners, the unitary tax must be imposed upon the "business income of all corporations engaged in the single unitary business." (Def. Brief, *Alcan I*, p.3, emphasis supplied)

The Petitioners concede the same things in this case. For example, on page 2 of their Brief in Response at the Seventh Circuit, they state that the FTB determined that, rather than calculating California income tax on the domestic subsidiaries' income, it "should be calculated on an apportioned share of the total business income of the respective multinational enterprises of which they are part." Petitioners ignore corporate distinctions and treat Respondent's worldwide operations as a single entity business:

The first step in the process is to identify those corporate entities and activities which constitute a single unitary business. (Emphasis added)

*Appellees' Reply Brief*, 860 F.2d 688 (7th Cir. 1988), at p. 2.

Again on page 5 of the same brief, the Petitioners state that "the Board determined that AlcanCorp and its immediate parent, Aluminium Company of Canada, Limited ("*Alcan Canada*"), were engaged in a single unitary

*business.* (Emphasis added, p. 5) Again on page 6, the Petitioners demonstrate their total disregard of separate corporate status, stating that "Alcancorp is part of a single unitary enterprise conducted by the Alcan Group Companies." Again on page 6, the Petitioners disregard Alcan's U.S. subsidiaries' separate U.S. activities and state equivocally that California tax liability is "an apportioned share of the total business income of the unitary business conducted by the Alcan Group Companies." (Emphasis added.) Finally, on page 25 of the Seventh Circuit Reply Brief, Petitioners state "it is impossible to say where the income of its [the unitary business] various components actually is 'earned.' "

What should put this entire issue of what is being taxed beyond dispute is this Court's recognition in *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983), that what is being taxed is not the income of a corporate subsidiary, but the income of the unitary business, and it states that in unequivocal terms. The existence of the concept of a shareholder is quite irrelevant to the process and not mentioned by the Court:

The unitary business/formula apportionment method is a very different approach to the problem of taxing businesses operating in more than one jurisdiction. It rejects geographical or transactional accounting, and instead calculates the local tax base by first defining the scope of the "unitary business" of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that "unitary business" between the taxing jurisdiction and the rest of the world. . . .

463 U.S. at 164-165 (emphasis added).

Now, in comes the Respondent, parent of the Alcan Group Companies, to complain about the fact that its status as shareholder, and what should be concomitant insulation of its foreign income, is being ignored for the purpose of calculating the California tax. It comes complaining about the fact that, rather than being treated as a shareholder of its U.S. subsidiary, it and its U.S. subsidiary are treated as a "single" business. And Petitioners'

answer is to hypocritically claim "you are only a shareholder."

This Court should recognize this charade for what it is and hold, as did the Seventh Circuit, that when California elected to treat the Alcan Group Companies as one business, it ignored the Respondent's shareholder status, and having done so, it cannot now rely on that status to avoid being challenged for having ignored it in the first instance!

## B. THIS CASE INVOLVES A CONSTITUTIONAL DUTY OWED DIRECTLY TO RESPONDENT

In arguing that Respondent's only remedy is through a suit by its subsidiary, Alcancorp, Petitioners are urging this Court to adopt a procedural remedy that, in effect, presupposes the constitutionality of WCA as applied to foreign parents. For the very same reason, Respondent has been tenacious in insisting on its right to complain about the tax.

Perhaps the most elegant expression of this principle is that of the Seventh Circuit which stated:

It is the incidence of the unitary tax, its potential to disfavor a particular mode of foreign participation in the American economy, rather than the magnitude of the cost it imposes that provides the strongest argument for standing.

860 F.2d, at 697. (Petition for Writ at A-15.)

It was the expectation of Respondent when it invested in the United States that if it entered the United States through the use of a subsidiary, the only impact it would see on its non-U.S. activities would follow exclusively through its shareholder status. Respondent did not expect every activity it conducted outside of the United States would influence liability for California income tax.

Respondent has recognized the longstanding rule that shareholders may not sue in their own right to

vindicate a claim against a corporation. However, it is equally recognized that this rule does not apply where there is a breach of a duty owed to the shareholder:

The general rule is, of course, well established that an action to redress injuries to a corporation, whether arising out of a contract or tort, cannot be maintained by a stockholder in his own name, but must be brought in the name of the corporation, the stockholder's rights are merely derivative and can only be asserted through the corporation. *The rule does not apply in a case where the stockholder shows a violation of a duty owed directly to him.*

*Schaffer v. Universal Rundle Corp.*, 397 F.2d 893, 896 (5th Cir. 1968), emphasis added.

The constitutional issue in this case is essentially a dispute over whether WCA applied to the unitary business headed by Respondent contravenes a constitutional duty owed to it.

The Petitioners and the Amici have put great weight on the existence of a remedy for AlcanCorp in the state courts. That is perhaps the best example of how a decision on standing effectively determines the merits of the constitutional controversy. If this Court were to determine that Respondent does not have standing because its only injury from the tax is derived from its shareholder status and the constitutional claim must be pursued in the state courts, the question then arises as to the nature of the constitutional challenge in the State Court. If it has been established that the only impact of WCA on foreign commerce derives from Respondent's status as shareholder, this impact is not a burden on foreign commerce and no constitutional injury occurs. *In short, this Court cannot determine the shareholder-standing issue adversely to Respondent without simultaneously resolving the constitutional issue to Respondent's detriment!*

**C. THE HOLDINGS OF THE SECOND CIRCUIT IN *ALCAN I* AND THE NINTH CIRCUIT IN THE FIRST *EMI*<sup>4</sup> DECISION BOTH SUPPORT THE PROPOSITION THAT STANDING CANNOT BE ADDRESSED WITHOUT ADDRESSING THE MERITS**

Petitioners place great weight on the proposition that the standing issue is in dispute among the Circuits. They are correct. However, they gloss over the reasoning in the cases which illustrates two critical points. In *Alcan I*, the Second Circuit Court of Appeals, relying on the reasoning of the District Court, held that Respondent lacked standing because there was no independent and direct injury from WCA, since it believed that this Court had resolved the constitutionality of WCA as applied to foreign parent combinations in *Mobil Oil v. Commissioner of Taxation*, 445 U.S. 425 (1980). The district court in *Alcan I* reasoned as follows:

In an attempt to assert standing for itself in this action, plaintiff claims that the FTB has imposed a tax directly on its income. This is not so. California's unitary tax is specifically structured so as to tax a corporation proportionate to the amount of business it does within the State; the unitary method is not a tax on non-California businesses or income. Because the profits of a unitary business "arise from the operation of the business as a whole, it becomes misleading to characterize the income as having a single identifiable source." *Mobil Oil Company v. Commissioner of Taxation*, 445 U.S. 425, 438 (1980) The Supreme Court there recognized such unitary schemes to be valid method of corporate taxation. . . . cites omitted. Thus the plaintiff's claim of a direct tax on itself is invalid and Alcan has no "distinct palpable injury" on which to base a claim of standing. . . . Plaintiff seeks to further bolster its

<sup>4</sup> *Capitol Indus. - EMI Ltd., Inc. v. Bennett*, 681 F.2d 1107 (9th Cir. 1982), cert. den., 455 U.S. 943 (1982).

argument against formula apportionment by emphasizing the foreign source of the income being taxed. In a strained syllogism, plaintiff argues that a) unitary taxation is a tax on foreign commerce, b) Alcan-corp engages in no foreign commerce, so c) the tax must be upon Alcan rather than its subsidiary. As previously demonstrated, the unitary tax is imposed neither upon foreign commerce nor Alcan itself. The weakness of the plaintiff's logic aside, this assertion once again ignores Mobil Oil, which held that the foreign source income does not preclude its taxation under the unitary method.

558 F.Supp., at 627 (emphasis added).

Rather than making Petitioners' point, the Second Circuit makes our point. You cannot resolve the standing issue without resolving the merits. This is amply illustrated by the logic of the district court, adopted in whole by the Second Circuit, which held that standing did not exist because WCA as applied to foreign parent combinations was constitutional.

*EMI Ltd. v. Bennett*, 738 F.2d 994 (9th Cir. 1984), cert. den., 469 U.S. 1073 (1984), is not much more help to the Petitioners. In attempting to arrive at a predetermined destination, the Ninth Circuit tripped over its own logic. In seeking to minimize EMI's claim of direct injury by ignoring explicit allegations to the contrary, it concluded that EMI's only injury was to the value of its stockholdings<sup>5</sup> - it suffered no direct injury from the tax. What the Ninth Circuit had forgotten was its own recognition of a direct injury when it rejected the bar to a foreign parent suit under the Tax Injunction Act (28 U.S.C. § 1341), stating quite explicitly that Petitioners should have provided a direct remedy to EMI in the WCA taxing scheme:

Allowing a parent corporation to bring an action in federal district court to challenge a state tax assessment against its subsidiary corporation could result in the circumvention of state remedial procedures

<sup>5</sup> See *Shell supra* for same reasoning.

that Section 1341 was intended to prevent. See note 12 *supra*. Moreover, simultaneous federal and state actions involving substantially similar issues clearly is not desirable. California, however, could eliminate both problems by clearly providing a judicial or administrative remedy in which such non-taxpaying entities, which are interested parties and have stated a claim with respect to an assessment, could participate as parties. (Such a remedy might be particularly appropriate where the state is applying the unitary assessment method to a domestic subsidiary and its foreign parent, and where the state is demanding the business records of the foreign parent.)

*Capitol Industries-EMI, Inc. v. Bennett*, 681 F.2d 1107, 1119 fn. 32 (9th Cir. 1982) cert. den., 455 U.S. 943 (1982).

Now, why should someone who has no direct injury be entitled to their own direct remedy?

In sum, these cases hurt Petitioners rather than help them. Petitioners' prime objective is to avoid resolution of the merits of the constitutional controversy. These cases demonstrate that an intellectually honest and consistent assessment of the standing can only be made in the context of a resolution of the merits of the constitutional issue.

#### D. THE SEVENTH CIRCUIT, LIKE THE SECOND CIRCUIT BEFORE, RESOLVED THE STANDING ISSUE BY ADDRESSING THE MERITS

Perhaps the most telling example of how the merits and the issue of standing are inextricably related are the words of the Petitioners who lament in their opening brief:

The Court of Appeals has confused these constitutional claims with the essential question of standing: whether the parent-stockholder, or the corporate taxpayers, are the proper parties to litigate the constitutional claims.

Petitioners' Brief, p. 32.

Of course, the Seventh Circuit was no more confused than the Second Circuit; each Circuit reached a different

result on the constitutional merits of the tax<sup>6</sup> and concomitantly reached a different result on the issue of standing. In fact, when Petitioners attempt to reduce the standing question to one of pure procedure, it finds itself in the same predicament as the Ninth Circuit – one of contradiction.

**1. Petitioner Attempts To Argue That WCA Can Create No Direct Injury Because No Form Of Business Transaction, Even One At Arms Length, Between Unrelated Parties Will Be Subject To Unitary Treatment**

The Seventh Circuit has expressed the direct injury to Respondent created by WCA most eloquently to date. It said that the injury was that WCA effectively deprived foreign parents of the tax benefits of operating in foreign commerce through the vehicle of subsidiaries.

Petitioners have attempted to recharacterize this by saying that the Seventh Circuit rejected our claims of injury *to wit*: double taxation and substantial compliance burden.<sup>7</sup>

Rather than rejecting these as injuries, the Seventh Circuit merely stated that “viewed narrowly” these claims “may” not be enough. Rather, the court concluded it was the fact that the “incidence” of these problems fell

<sup>6</sup> Although the Seventh Circuit never expressly disclaimed reaching the merits of the constitutional issue, its views are clear, as clear as its position on standing in *Alcan II*, where it also disclaimed it reached the merits of the standing controversy.

<sup>7</sup> As will be addressed later herein, these two elements have only been part of the direct burden urged by the Respondent which Respondent described at oral argument at the Seventh Circuit as a “Total Business Burden”.

in foreign commerce, and that all the effects of the tax combined to essentially eliminate the well accepted benefits of the subsidiary as a means of making foreign investment, which gave rise to standing. In short, under the WCA method of taxation the foreign parent is treated for tax purposes as though it operated directly in the United States without any benefit of shareholder status. Each of the consequences of WCA, in effect, combined to eliminate the subsidiary as an economically distinguishable alternative for conducting foreign investment. Thus, the Seventh Circuit did not reject our claims to “direct injury”, rather it said that the injury is not the double tax or compliance cost, *per se*, but rather the net economic impact in the context of foreign parent investment. The result is to limit a foreign parent to contract operations with third parties in order to achieve the same tax consequences one would normally get by operating through a subsidiary.

Petitioners’ mischaracterization of the Seventh Circuit’s reasoning notwithstanding, they clearly understand what the Court was saying as is demonstrated by their rather sad attempt to argue that operating through a subsidiary is no different than operating in any other format. Their argument is more than wrong; it makes the opposite point. First, they try to suggest that in order to operate in the United States as the Respondent does, manufacturing, research and selling must be conducted by direct investment. To describe that conclusion as naive would be charitable. In fact, it is well established that one is capable of operating an entire business from the design through marketing on a contract basis.

Implicitly recognizing that no reasonably sophisticated person is going to accept their characterization of business practices, Petitioners then attempt to argue that even if we could operate by contract it would make no difference. In their Petition for Rehearing, they argued that they would treat as unitary the contract operator who was unrelated and dealing at arms length with the

foreign company. In the Brief before this Court, Petitioners try to back away from that erroneous argument, and in doing so they back away from the point they want to make. Now, Petitioners argue they only intended to treat the foreign parent as unitary. That, of course, will not result in equivalent tax treatment. For example, if a foreign parent purchased finished goods in California for resale outside California, there could be no unitary treatment since it had no payroll, sales and property in the State. If it produced those goods through a subsidiary, there would be unitary treatment. That is exactly the point that the Seventh Circuit makes.

## 2. Petitioners Suffer From Contradiction As Did The Ninth Circuit in *EMI*

Like the Ninth Circuit, who found that the injury to *EMI* was simply derivative and simultaneously lamented the fact that *EMI*'s independent injury deserved its own independent right of action in the State Court, Petitioners find contradiction plaguing their reasoning.

On pages 27 through 29 of the Brief on the Merits, the Petitioners argue that, no matter what form of business one selects, the tax treatment is the same. This is Petitioners' effort to show there is no burden. They conclude in this respect:

The unitary method would be used to determine taxable income attributable to California regardless of the form chosen.

Petitioners' Brief, p. 31.

After having taken almost three pages in trying to show that regardless of the form of business you select the tax consequences will be the same, just a page later they make the opposite argument in attempting to argue that even if there is a burden it is not "a cognizable injury for standing purposes":

In effect the Court of Appeals has held that, everything else being equal, a foreign company should not be faced with a state tax law which would tend to

discourage one form of business over another. . . . It is a fact of life, however, that tax consequences often vary, depending upon the form of doing business, the form of a particular business transaction, etc.

Petitioners' Brief, p. 31.

Having to play both sides of the fence is the natural consequence of denying the reality of *WCA*. The Petitioners ignored our shareholder status in assessing the tax, then deny us access to complain about the fact we are not being treated like a shareholder by claiming we are a shareholder. Once you take the position of supporting the Petitioners, as the Ninth Circuit did in *EMI*, consistency of reasoning is foreclosed.

## II. THERE IS A "TOTAL BUSINESS BURDEN" ON RESPONDENT WHICH IS DIRECT AND CONSISTS OF AN UNCONSTITUTIONAL IMPACT ON FOREIGN COMMERCE WHERE RESPONDENT AND ITS FOREIGN SUBSIDIARIES EXCLUSIVELY OPERATE.

As we have demonstrated, it is simply impossible to resolve the standing issue without resolving the fundamental constitutional issue. Put another way, if Respondent suffers no direct burden on its foreign commerce and has no standing, then this Court has effectively decided the foreign commerce issue. It is well recognized that burdens derived through shareholder status do not create burdens on foreign commerce. If Respondent has no standing, there is no foreign commerce issue to be raised in the state court by the U.S. subsidiary - the matter is resolved.

Thus the issue is whether the burden imposed by *WCA* is direct, and therefore, unconstitutional, or whether it is derived. If the tax is unconstitutional, it is by definition direct and not simply derived through one's status as a shareholder. Incredibly, notwithstanding comprehensive argument to the contrary, the Petitioners assert:

Furthermore, Alcan and Imperial have never explained why taxes imposed on AlcanCorp and Americas would directly injure the parent companies even if the tax is not measured solely by the subsidiaries' income.

Petitioners' Brief, p. 37

In fact, as Petitioners have argued in every preceding case, WCA implicates every facet of a company's operation directly and by every reasonable standard articulated by this Court, its impact on Respondent's activities in foreign commerce is both direct and unconstitutional.

Whether there is an impermissible burden on foreign commerce is governed by the principles enunciated by this Court in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979). In that case, this Court prohibited the application of a property tax to cargo containers engaged in foreign commerce and, in doing so, detailed some objective tests for determining whether a state tax unconstitutionally burdens foreign commerce.

A recent case before this Court, *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983), considered the application of the principles of *Japan Line* to WCA for American-parent, foreign-subsubsidiary combinations. In that case, this Court held that WCA applied to American-parent, foreign-subsubsidiary combinations did not violate the Foreign Commerce Clause; however, it explicitly excepted from its ruling the case of foreign-parent, domestic-subsubsidiary combinations. This case presents the precise issue left unanswered in *Container*. When one examines this Court's reasons in *Container* for excluding the foreign parent case, it becomes clear that imposing WCA on foreign parent combinations offends the principles of *Japan Line* and violates the Foreign Commerce Clause of the U.S. Constitution.

The stipulated record below establishes that Respondent's factual allegations in its complaint are true. Thus it has standing and its activities in foreign commerce suffer from the burden imposed by WCA. Consequently, WCA

as applied to foreign-parent, U.S.-subsidiary combinations violates the Foreign Commerce Clause of the U.S. Constitution, in that it constitutes a direct rather derivative impact on Respondent.

#### A. Administrative Burden

With respect to the existence of the administrative burden, there are a number of stipulations demonstrating that the information necessary to administer the tax comes from the Respondent or its non-United States subsidiaries. For example, Stipulation #25 describes the mechanism utilized to develop the data used as the basis by the Petitioners in allowing accelerated depreciation. The stipulation shows that of the total hours spent on the project, 88% of the time was hours spent outside the United States and 85% of the time, or 875 hours, was time spent by personnel of the Respondent or its non-United States subsidiaries. (JA at 73)

This vast amount of time was spent on the Petitioners' short-cut method<sup>8</sup> which, it is worth adding, was only allowed by the Petitioners after the Respondent began the series of lawsuits (culminating in this one) challenging WCA.<sup>9</sup> If the Respondent had not permitted the short-cut method (it is not under a legal obligation to allow approximations<sup>10</sup>), and Respondent was obligated

<sup>8</sup> At a per hour accountant cost of \$70 per hour, the direct cost to Plaintiff was \$61,250; certainly not de minimus!

<sup>9</sup> Plaintiff started its actions against the FTB in June of 1981. The FTB allowed accelerated depreciation deductions as follows:

1965 through 1971	allowed	September 18, 1985
1971 through 1974	allowed	March 8, 1984
1974 through 1978	allowed	March 8, 1984

<sup>10</sup> Cal. reg. §25137-7(e), Stip #20, permits the FTB to use reasonable approximations but does not require it to do so. (JA at 70)

to calculate actual accelerated depreciation, the cost would include a \$3.8 million investment in a computer system (software) and an additional \$2.2 million in yearly manhours (Stip. #35, JA at 82).

Moreover, it is not merely accelerated depreciation which imposes costly administrative demands on the Respondent. The Last In First Out ("LIFO") inventory method has never been allowed by the Board although it has been requested on numerous occasions (Stip. #22, *Id.* at 70-71). If Respondent were to actually use the LIFO inventory method and follow the same methodology as AlcanCorp, the cost would be even more devastating, adding an additional \$3.5 million of yearly manhours (Stip. #35, *Id.* at 83).

However, one need not look simply to the administrative burden of calculating the deductions applicable to the tax to find administrative burdens imposed by WCA on the Respondent. Virtually all the information necessary for the administration of the tax must be obtained from the Respondent. For example, in Stipulation #21 (*Id.* at 70), it was noted that the Board's calculations of the tax was based on published data of the Respondent "and other information submitted by AlcanCorp which was obtained from [Respondent]." In Stipulation #22 (*Id.* at 71), it is stated that the calculation of business income involved a number of adjustments and that the calculation of percentage depletion and accelerated depreciation was "based upon data supplied by AlcanCorp which it obtained from [Respondent]." Additional reliance on the Respondent for the proper administration of the tax is described in Stipulation #26(b) (determination of proper worldwide payroll calculation) and Stipulation #32 (election of tax accounting methods) (*Id.* at 74 and 78).

In short, the nature of WCA reporting is that it cannot be administered without placing a substantial burden upon the worldwide organization. This burden is exacerbated in the case of foreign parents for two reasons. First, foreign parents, including the Respondent, generally have a far larger part of their investment outside of the

United States than does the typical American parent with foreign subsidiaries.

Second, their burden is not necessary for their own federal tax compliance. WCA bases a substantial part of its tax scheme on the U.S. federal tax scheme. Since American parents are subject to U.S. federal taxation, the additional effort for those parents to comply with WCA is minimal. However, since foreign parents are not subject to U.S. federal taxation, the effort they must undergo to comply with the U.S. federal tax scheme is unique to WCA. The WCA has the net effect of forcing the Respondent to undertake the same administrative tax burden<sup>11</sup> it would have as a U.S. corporation.

This burden has resulted in the numerous complaints of foreign nations to this scheme. See, for example, the letter of then Minister of Finance of the Government of Canada, Marc Lalonde, to the then Secretary of the Treasury of the United States, Donald T. Regan, (*Brief of Appellant Alcan*, 860 F.2d 688, 7th Cir. 1988 [Appendix Exhibit "D"]), where the Canadian Minister said in relevant part:

Second, the costs of compliance arising out of the need to prepare consolidated returns that conform to the state tax accounting requirements are particularly onerous for Canadian and other foreign based companies.

In sum, this constitutes a significant direct burden on Respondent.

<sup>11</sup> In *Container*, the Court noted at 196:

[T]he United States is a party to a great number of tax treaties that require the Federal Government to adopt some of arm's length analysis in taxing the domestic income of multinational enterprises . . .

The irony of this observation in the context of a foreign parent is that foreign parents are forced by the FTB to assume the same administrative burden of compliance that the federal government is prohibited from imposing by treaty!

## B. Double Taxation

Respondent has also established that the application of WCA constitutes "double taxation." In *Container*, this Court noted that actual double taxation exists when income is taxed by the host country as wholly attributable to it, and then included in the California tax base:

First, the tax imposed here, like the tax imposed in *Japan Line*, has resulted in actual double taxation, in the sense that some of the income taxed without apportionment by foreign nations as attributable to appellant's foreign subsidiaries was also taxed by California as attributable to the state's share of the total income of the unitary business of which those subsidiaries are a part.

463 U.S., at 196.<sup>13</sup>

Actual double taxation exists in this case. Stipulation #42 (JA at 85) details the taxes paid by the Alcan Unitary Business, by company, to each host jurisdiction in the years 1971, 1977 and 1978. (The parties have agreed that those years are representative – see Stip. #1, JA at 63-64.) In each year the pre-tax income per the financial statements correlates exactly with the California pre-apportioned income. This income was clearly taxed already by host jurisdictions. In 1971, the Alcan Companies had paid \$38,321,000 in taxes to host jurisdictions. In 1977, the Alcan Group Companies had paid \$53,544,000 to host countries (excluding the U.S.) and in 1978, they paid \$75,813,000 (excluding the U.S.) in taxes to host countries. Notwithstanding the fact that significant income tax was already paid to host jurisdictions, WCA again apportioned some of the income to California and taxed it again, thus resulting in *actual double taxation*.

<sup>13</sup> Petitioner at page 37 of its brief argues that this Court rejected this position in *Shell Oil Company v. Iowa Dept. of Revenue*, \_\_\_ U.S. \_\_\_, 109 S. Ct. 278, 102 L. Ed. 2d 186 (1988). See also p. 6, *infra*.

Clearly, Respondent's income, not AlcanCorp's, is subject to double taxation which is necessarily and exclusively an injury to Respondent.

## C. WCA is a Tax Upon Respondent

Finally, Respondent has established the allegation of paragraph 17 of its complaint that WCA is more than an apportionment formula, it actually imposes a tax on Respondent and its non-United States subsidiaries. This can be best illustrated by a hypothetical example. Assume that a local plant manager in one of Respondent's plants in India decides that he can make his plant more productive by rearranging the production process. The rearranging allows him to eliminate some equipment and not replace some retiring employees, while still producing the same output at a lower unit cost. The articles produced are then sold at a lower price in India. What is the net result of his actions? Incredibly, California income tax goes up.<sup>14</sup> Clearly, the activity in India is being taxed, since tax liability is contingent on its activities.

It is true that the same result would occur in the context of an American parent. However, as this Court noted in *Container*, the ultimate economic impact of WCA on an American parent is in the United States, 463 U.S. at 195. Conversely, in the case of a foreign parent, the economic impact is outside the United States. Any increase in U.S. tax liability decreases revenues in Canada for the Respondent.

Moreover, WCA subjects each one of Respondent's one hundred subsidiaries to the exact burden as in the hypothetical example, and the net economic burden of this imposition of tax liability falls on the Respondent in Canada.

<sup>14</sup> The increase results from the fact that the changes would decrease worldwide sales, payroll and property and thus increase California's relative share of sales, payroll and property.

In the context of Respondent's case, the fact that WCA imposes a tax on Respondent and its foreign subsidiaries is even more dramatically illustrated by the tax imposed by the Petitioners in connection with Alcan-corp's Riverside, California facility. The facility was acquired from the Bridgeport Brass Division of National Distillers and Chemical Corporation. When it was acquired, the facility was losing money on the books of National Distillers and Chemical Corporation. Yet, the minute it came into possession of AlcanCorp, WCA began attributing income to the facility and taxing it (Stips. #10, #47, #48 and #49; JA at 66-67, 97 and 98).

The Petitioners may attempt to argue that this tax on an entity that is losing money according to its separate books and accounts is justified because there are undetectable transfers of value that are not reflected in regular books and accounts. However, because these hypothetical transfers are undetectable, they, like religious beliefs, must be taken on faith since as Freud commented, the nature of faith is that its validity can neither be proven nor disproven:

Of the reality value of most of [religious beliefs] we cannot judge; just as they cannot be proved, so they cannot be refuted.

Freud, Sigmund, *Future of An Illusion*. (W. W. Norton & Co., Inc., New York, 1961), p. 31.

When one goes beyond faith to the objective data, the conclusion that the Petitioners in Riverside were simply taxing the Respondent's income derived from sources outside of the U.S. is inescapable. Riverside, throughout its life as an AlcanCorp plant, lost \$5 million. Nonetheless, the Petitioner taxed it as though it earned \$15 million (Stip. #49, JA at 97). Throughout its life, transactions between Riverside and Alcan Group Companies were reviewed by Revenue Canada and the U.S. treasury, and no adjustments were made.

Also, during the life of the plant, AlcanCorp was under a consent order with the U.S. Department of Justice to sell the Riverside facility, but was unable to do so (Stip.

#50, *Id.* at 98). The reason was simple, the facility was losing money; it had no going concern value, and ultimately AlcanCorp shut the facility down and scrapped it (Stip. #50, *Id.* at 98).

Now, why would a company scrap a plant producing the income that WCA attributed to it? Why would a company forego all the secret value that the advocates of WCA claimed was being transferred out of California? The answer is simple and obvious. There was no secret transfer of value. The facility was losing money when Alcan bought it. It continued to lose money. It was recognized by the marketplace and the Internal Revenue Service as a loser, and was finally shut down and scrapped when AlcanCorp management realized that no reasonable effort could make the facility profitable.

Management's view of what California was taxing as highly profitable is concisely stated in this excerpt from the Request For Authorization to scrap the facility, attached as part of Stipulation #50 (JA at 88):

The Riverside sheet products operation has lost money in every year since 1972, averaging some \$900,000 of loss before interest and tax per year during the last four years.

The current Annual Plan predicts a loss of \$1.3 million in 1976 and a further loss of \$0.7 million next year (after interest but before tax). Sales and booking volumes are running about 10% under plan levels so a substantial additional loss, perhaps up to \$0.2 million, can be anticipated.

With a few exceptions, the Riverside equipment is narrow and obsolete. Due to the growth pattern of the facility, the layout is inefficient and the "wide" casting and hot rolling line is too narrow even for double width siding. Any modernization program to increase width capabilities beyond 26" would have to embrace almost the entire plant and would probably cost as much as or more than starting on a green fields basis. The California market would not justify this sort of expenditure.

Stipulation of Facts, par. 50, Exhibit XXI.

Where, then did the Petitioners get the \$20 million necessary to offset the \$5 million loss and create a \$15 million profit? The answer is simple and unequivocal. The Petitioners were simply assessing their tax against the Respondent's foreign income, earned and already fully taxed by the host county in which it was earned.

Although it is true, as this Court states in *Container*, 463 U.S. at 188, that WCA, unlike the tax in *Japan Line*, does not result in inevitable double taxation, when the tax is applied to foreign parents that distinction is theoretical rather than substantive. This results from the fact that the Petitioners have selected apportionment factors which, when applied in the context of foreign parents having the vast majority of their investments abroad, will almost always result in the attribution of foreign income into the California tax base. This can be illustrated by a comparison of profit rates in the U.S. as opposed to foreign operations.

Table 1, set forth below,<sup>15</sup> is a comparison of hourly earnings of manufacturing personnel in foreign countries

<sup>15</sup> TABLE 1

Hourly Earnings Rates Translated into  
United States Dollars for Wage Earners  
in Manufacturing Industries

Country	Year		
	1967	1968	1969
United States	\$2.83	\$3.01	\$3.19
Australia	1.21M	1.28M	1.36M
Austria	.88	.93	.99
Belgium	1.04M	1.09M	1.19M
Brazil	.38	.35	.41
Canada	2.22	2.40	2.60
Denmark	1.62	1.80	2.02
France	.69	.77	.76
Germany, F. R.	1.25M	1.20M	1.55M
Greece	.42	.46	.50

(Continued on following page)

translated into United States dollars. It demonstrates quite clearly the unsurprising fact that wage scales in various countries differ sharply. These differences in wages, however, have a significant impact on the application of the unitary method which takes into account the payroll of Respondent and its non-United States subsidiaries in computing "California" apportioned income. Because Petitioners fail to take account of the variances in wage scales in different countries, the unitary tax method attributes far more net income to California than is actually warranted – and that income is derived from foreign operations of Respondent.

Furthermore, differences in worker productivity levels also produce distortion of the income attributed to California under the unitary tax method applied by Petitioners. Table 2, set forth below,<sup>16</sup> compares the productivity of an American worker to a foreign worker on per

(Continued from previous page)

Italy	.68	.71	.78
Spain	.41	.45	.50
Sweden	1.91M	2.02M	2.21M
United Kingdom	1.16	1.23	1.34

Source: United Nations Monthly Bulletin of Statistics, December, 1972, Table 57 at 148 based on data from International Labor Office. Amounts followed by the letter "M" note wages for males only.

<sup>16</sup> TABLE 2

Percentage of U.S. Average Hourly Compensation  
Adjusted for Estimated Differences in Productivity

Country	1969	1970
Japan	40	40
West Germany	61	72
United Kingdom	65	68
Belgium	60	61

(Continued on following page)

wage dollar basis. It demonstrates that an American employee, for instance, produces only 40% of what a Japanese worker produces for each dollar he is paid. However, because this factor is not taken into account by Petitioners in assessing tax under the unitary method, "California" apportioned income again is greatly inflated.<sup>17</sup> Tables 1 and 2, therefore, indicate that different wage scales and increased worker productivity on a per dollar basis in foreign nations results in the attribution of income to the California tax base.

This attribution of income has long been recognized by the United States government as taxing foreign corporations. In this regard, former Secretary of the Treasury William Simon stated in an October 21, 1978, letter to U.S. Senator Quentin N. Burdick:

[T]he unitary system contains the implicit assumption that profit rates in different units of a corporate family, engaged in different activities or in different locations are always the same. This is clearly not the case. Thus, to the extent profit rates differ, the unitary system misallocates income. Whenever profit rates are higher in foreign affiliates than in domestic activities, the unitary system does have the effect of taxing foreign corporations."

(Continued from previous page)

Canada	79	82
France	58	54
Italy	62	67
Netherlands	74	71
Sweden	72	74

Source: United States Tariff Commission, "Competitiveness of U.S. Industries," T.C. Publication 473 at 30 (1972).

<sup>17</sup> Since the payroll factor is measured in U.S. dollars and since the U.S. worker is paid more money for less output, the formula will attribute income to California even though it is clear that more profits are being made on the Japanese product with the lower labor cost.

Brief of Appellant Alcan, *Alcan Aluminium Limited v. Franchise Tax Board of California*, 860 F.2d 688 (7th Cir. 1988) ("Alcan's 7th Circuit Brief"), Appendix Exhibit "F", emphasis supplied.

In a statement on July 19, 1977, before the Senate Foreign Relations Committee, former Assistant Secretary of the Treasury Lawrence N. Woodworth also stated:

California tax authorities appear to construe the definition of a unitary business very broadly, so that related entities which appear to be independently engaged in very different kinds of activities are aggregated into a unitary business and must be included in a combined report to the tax authorities. "The combined report is, in effect a consolidated return in the controlled group's worldwide income. . . .

*Id.* an Appendix Exhibit "G", emphasis supplied.

The same point was made by former Assistant Secretary of the Treasury for Tax Policy Donald C. Lubick in his testimony before the House Ways and Means Committee on March 31, 1980:

Now, obviously, if there are different relationships between the factors in different jurisdictions, you are going to have distortions. For example, in the United States we may tend to have payrolls as a larger ratio of sales in the conduct of business than in many other jurisdictions. That means that the weighting of payrolls in the United States to total payrolls is going to allocate more income to a particular jurisdiction. Now this is a perfectly time-accepted and tolerable method of operation when you are dealing with multistate operations, but when you are dealing with many jurisdictions around the world, it does produce some very serious distortions.

*Id.* at Appendix Exhibit "H" at 4, emphasis supplied.

Table 3 shows where the income was earned which became the basis for Riverside's "profitability" in 1971.

TABLE 3

SOURCES OF INCOME FOR ASSESSMENT  
OF TAX ON ALCANCORP BY CALIFORNIA IN 1971

	PRE-TAX FINANCIAL INCOME (000'S OMITTED)
Canada	\$49,990
Brazil	9,104
Malay	812
England	10,264
India	9,142
South Africa	1,602
France	423
New Zealand	1,600
Venezuela	365
Other Foreign Income	5,910
Equity Income, Minority Interest, etc.	16,020
United States (Alcancorp)	(2,484)
WCA Pre-Tax Income of Alcan Unitary Business	<u>\$102,758</u>

In 1971, Riverside incurred a loss of \$3,482,952 on a separating accounting basis while WCA taxed it as earning a profit of \$956,868 in California (Stip. #48, JA at 98). Clearly, the income being taxed came from sources outside of the United States. Thus, in the context of a foreign parent, double taxation may not be technically inevitable but it is certainly very likely, and that likelihood burdens foreign commerce since foreign corporations making business decisions wholly outside the United States must now consider their impact on U.S. tax liability.

In addition, as contrasted with the U.S. parent situation in *Container*, the impact of the double taxation is infinitely more onerous on foreign parents:

Of course, even the three-factor formula is necessarily imperfect. But we have seen no evidence demonstrating that the margin of error (systematic or not) inherent in the three-factor formula is greater than the margin of error (systematic or not) inherent in the

sort of separate accounting urged upon us by appellant. Indeed, it would be difficult to come to such a conclusion on the basis of the figures in this case: for all of appellant's statistics showing allegedly enormous distortions caused by the three-factor formula, the tables we set out at nn. 11-12, supra, reveal that the percentage increase in taxable income attributable to California between the methodology employed by appellant and the methodology employed by appellee comes to approximately 14%, a far cry from the more than 250% difference which led us to strike down the state tax in *Hans Rees' Sons, Inc.*, and a figure certainly within the substantial margin of error inherent in any method of attributing income among the components of a unitary business.

463 U.S., at 183-84, footnote omitted.

Here the distortion is a far cry from a mere 14%. In years 1971 and 1977, the distortion was not the mere 250% that horrified this Court in *Hans Rees' Sons, Inc. v. North Carolina ex rel Maxwell*, 283 U.S. 123 (1931), but infinite. And, in fact, the distortion attributable to Riverside over its life was infinite. This demonstrates the enormity of the distortion when the tax is applied to foreign parents.

Respondent has not only established the truth of the allegations, it has also demonstrated that they dramatically exceed, both in likelihood of occurrence and in impact, the burden imposed by WCA on American parent-foreign subsidiary combinations. Thus, Respondent has demonstrated that WCA as applied to foreign parent combinations constitutes a violation of the Foreign Commerce Clause of the U.S. Constitution because of its burdens on Respondent's foreign commerce, a direct burden on itself, and therefore, Respondent has standing.

**D. THE PRINCIPLES ENUNCIATED BY THE SUPREME COURT IN CONTAINER ESTABLISH THAT WCA APPLIED TO A FOREIGN PARENT IS AN UNCONSTITUTIONAL BURDEN ON THEIR ACTIVITIES IN FOREIGN COMMERCE.**

In *Container*, this Court addressed the issue of the application of WCA apportionment as applied to domestic parents and ruled in that case that WCA as applied to domestic parents was not an unconstitutional burden on foreign commerce. However, the Court explicitly exempted this type of case – the application of WCA apportionment to foreign parents – from that decision. See 463 U.S., at 189.

When one reviews the logic of this Court in *Container*, it becomes evident that WCA as applied to foreign parents is unconstitutional for three reasons. First, the tax as applied to foreign parents does not meet the fairness requirement of the Commerce Clause. Second, the critical distinctions drawn by this Court between the doctrine of *Japan Line* and the *Container* situation have no application in the foreign parent case. Third, this Court acknowledged that the *Container* situation was not governed by the *Japan Line* principles, whereas, the foreign parent case clearly was.

**1. WCA does not result in a fair tax when applied to foreign parents.**

This Court noted in *Container* that the commerce clause as well as due process require that a tax apportionment formula must be fair. 463 U.S., at 169.

Fairness, this Court stated, exists if the tax meets both of the following standards. First, the formula must be internally consistent. This means that if the tax were applied "by every jurisdiction, it would result in no more than all of the unitary business's income being taxed." *Id.* at 169.

Respondent does not dispute for purposes of this motion that the formula applied by the Petitioners meets this test; however, the tax does not meet the second requirement – external consistency.

External consistency means the formula must "actually reflect a reasonable sense as to how income is generated." In addition, this Court noted with respect to external consistency:

Nevertheless, we will strike down the application of an apportionment formula if the taxpayer can prove "by clear and cogent evidence" that the income attributed to the State is in fact "out of all appropriate proportions to the business transacted in that state," *Hans Rees' Sons, Inc.*, 283 U.S., at 135, or had "led to a grossly distorted results," . . .

*Id.* at 170.

In *Container*, this Court approved the formula as externally consistent and fair because the 14% distortion created by the formula was in its view *de minimus* and certainly well below the 250% distortion in *Hans Rees'*, *supra*, which the Court found so clearly offensive. In this case, however, before AlcanCorp started closing down facilities in California, the distortion in the two illustrative years of 1971 and 1977 was infinite!

Therefore, WCA as applied to foreign parent combinations is unfair because it is not externally consistent.

**2. The Critical Distinctions Drawn By This Court Between Japan Line And The Facts In Container Do Not Apply In This Case.**

In comparing *Japan Line* to the situation in *Container*, the Court noted four similarities: First, the existence of actual double taxation. Second, the fact that the double taxation stems from a serious divergence in the taxing schemes adopted by California and the foreign taxing authorities. Third, the scheme adopted by the foreign authorities is consistent with international practice and, fourth, the Federal Government expressed a preference for the arms length method.

This Court then noted three differences. First, the tax in *Japan Line* was a property tax; in *Container* it was an income tax. The Court referred to *Mobil Oil v. Commissioner of Taxation*, 445 U.S. 425 (1980), for the proposition that the reasons advanced for allocation of a property tax to a single situs "carry little force" in an income tax content.<sup>18</sup> 463 U.S., at 188. This Court never really explained why this distinction is particularly relevant; it certainly is not determinative, since the Court goes on to find other distinctions.

The Court does suggest that property taxes are easier to allocate than income taxes which are like "slicing a shadow", 463 U.S. at 192, therefore, justifying the inaccuracy inherent in the unitary method; however, such a conclusion would represent a complete misunderstanding of the nature of property taxation. A tangible property tax can be as illusive as an income tax, in fact, it was the illusive nature of tangible property taxes that gave rise to the unitary method of taxation in the late 1800's. Note that California admits as much in their *Instructions for Corporations Filing a Combined Report*; (Stip #20, JA at 70, Ex. X-1):

#### Development of the Unitary Method.

The unitary approach began in the 1870's in the field of property taxation. At that time, property taxation was the principal source of state revenues. In many of the western states the major property holders were the transcontinental railroads. The state successfully argued that the value of the railroad system lay not in the actual cost of rail and ties, but in the fact that the system connected two distant points and therefore represented an integrated economic unit of which each state could lay claim to its appropriate share. In other words, all the property was valued as

<sup>18</sup> As we demonstrate herein, the unitary concept was developed to allocate property taxed to more than a single situs.

a single unit and a portion of the unit's value was assigned to each state by a mathematical formula. Thus, even if the Court placed some reliance on its belief in some ease of allocation in property taxation versus income taxation, the Petitioners' own history of the unitary tax refutes the validity of that position.

The second distinction drawn by the Court is that in *Japan Line* the double taxation was "inevitable". Once again, the Court did not appear to rely on this distinction as determinative, since it goes on to a third distinction; and, once again, it was obviously focusing on the factual situation of the American parent. In the case of the foreign parent, double taxation is almost always inevitable.

In concluding that double taxation was inevitable in *Japan Line*, this Court in *Container* was concentrating on the fact that under unitary taxation it was possible for the formula to sometimes reduce liability as compared to the arms length method. This distinction is theoretically accurate, and in the context of an American parent, may even occur with some frequency, although California has reportedly adapted to those annoying occasions by finding the group was not unitary for that period.

However, in the context of foreign parents, there is no real distinction. Since foreign parents typically have much more investment outside the United States, and since productivity rates per dollar are almost always higher outside the U.S. (see Table 2, *infra* p. 17), the formula will almost always distort income. *That is exactly what has happened throughout the extensive tax period involved in this case.* Moreover, when the double taxation occurs, it is likely to be enormous in magnitude as contrasted with the American parent situation.

The third difference pointed out by the Court involved the impact of the tax. The Court noted that the tax fell on a domestic corporation domiciled and headquartered in the United States. The Court further stated with respect to this distinction, that it was really focusing on the actual economic impact of the tax. For example, when this Court pointed out that the "legal incidence" of

the tax is on a domestic corporation, it quickly notes in a footnote:

We recognize that the fact that the legal incidence of a tax falls on a corporation whose formal corporate domicile is domestic might be less significant in the case of a domestic corporation that was owned by foreign interests.

463 U.S., at 195, n. 32.

In the context of the American parent, the legal incidence of the tax and the economic burden, be it double taxation or the administrative burden of compliance, ultimately are U.S. problems, because the ultimate economic impact is in the U.S. Although the Court distinguished *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425 (1980) on legal grounds (463 U.S. at 194), *Container's* reference to *Mobil* in this regard is significant, because in economic terms *Container* and *Mobil* are essentially the same case. In *Mobil*, the Court was confronted with the unitary apportionment of foreign dividends after repatriation and concluded that, since the dividends had been repatriated, the use of unitary apportionment did not involve an issue of foreign commerce. In *Container*, the Court faced the application of unitary apportionment to consolidated financial income before repatriation, and although it acknowledged a closer connection with foreign commerce than *Mobil*, it still found the legal "incidence"<sup>19</sup> of the tax to be in the United States. Thus, in both *Mobil* and *Container*, it is clear that the economic incidence of the Tax is ultimately in the United States. The economic value of the American owned foreign subsidiary ultimately resides in the American parent and thus, in the United States. In fact, it is clear the Court never really views the domestic parent problem as a foreign commerce issue since it never believed that the

<sup>19</sup> This contrasts directly with the reasoning of the Seventh Circuit, who predicated finding of direct injury on the foreign "incidence" of the tax.

impact of the tax would really lead to significant foreign retaliation:

Nevertheless, three distinct factors, which we have already discussed in one way or another, seem to us to weigh strongly against the conclusion that the tax imposed by California might justifiably lead to foreign retaliation.

463 U.S., at 194.

This reasoning is consistent with the fact that both this Court and the United States Government have long recognized that the real foreign commerce dispute involved foreign parents, not American parents, as this dialogue between the Court and the Solicitor General in *Chicago Bridge & Iron Co. v. Caterpillar Tractor Co.*, 463 U.S. 1220 (1983), illustrates:

THE COURT: And you say that this - the Illinois provision for the type of taxation they imposed, if imposed on anyone at all, would violate the federal commerce clause of the Constitution?

MR. SMITH: We so submit, and indeed, foreign governments have so protested to the United States.

THE COURT: Well, we don't usually rely on foreign governments to tell us what violates the commerce clause, do we?

MR. SMITH: That is true, but I think that in conducting the foreign relations of the United States, the United States government necessarily has to take into account that a particular state method of taxation which is undisputably at loggerheads and quite different and based on completely different theoretical assumptions than the international norm necessarily introduces an irritant to the conduct of our foreign relations that the government can feel is sufficiently serious to impede the conduct of our foreign policy and

thereby, create a foreign commerce clause problem. I think that was the basis of the Court's -

THE COURT: Do you think your trading partners should really object if the states applied this method of American parents with subs abroad, but didn't apply this method to the United States subs of foreign parents?

MR. SMITH: I cannot speculate -

THE COURT: I suppose the latter is what really worries the -

MR. SMITH: I cannot speculate as to what foreign governments would or would not find objectionable. It is true that the state and many of its supporting amici seek to minimize the seriousness of the diplomatic protest that we avert to, and which the other amici avert to by emphasizing that they address the case of a foreign parent with a domestic subsidiary, and I - to be sure, the United States views the case of a foreign parent with particular and special concern, because of the burdensome record-keeping in conforming with the U.S. Dollar accounting principles -

Alcan's 7th Circuit Brief, Appendix Exhibit "I" at 19-21.

Moreover, if the issue of retaliation were ever in doubt, it may now be put to rest because of the action of the British Government in passing legislation aimed at retaliation against California's imposition of the tax on unitary groups owned by its nationals.<sup>20</sup> The fear of companies who will suffer from this retaliation is illustrated by the April 9, 1985, letter from the president of Exxon Corporation to Secretary of the Treasury James

<sup>20</sup> House of Commons Official Report, *Parliamentary Debates* (Hansard), pp. 1014-18 (10 July 1985).

A. Baker, attached as Appendix Exhibit "J" to Alcan's 7th Circuit Brief, which states in relevant part:

Dear Mr. Secretary:

There is pending in the United States District Court for Northern District of Illinois (Civil #84C932) an injunctive suit by two foreign-based multinational companies, Alcan Aluminum [sic] Limited (Canada) and Imperial Chemicals Industry PLC (U.K.) against the Franchise Tax Board of California. The Court has recognized that the plaintiffs have standing to sue and that their complaints state a prima facie case for injunctive relief.

The two principle [sic] issues presented are (1) whether California Worldwide Unitary Taxation imposed double-taxation in contravention of the tax conventions between the United States and its principle [sic] trading partners, and (2) whether such taxation imposes a burden upon the foreign commerce and foreign relations of the United States in contravention of the Commerce Clause of the Constitution. Inasmuch as both of these issues concern fundamental principles of substantial importance to the United States, we urge you to express the views of the United States in this case. There is precedent for taking this action, the most recent of which that comes to mind is the memorandum filed by the United States as Amicus Curiae in the case captioned *Chicago Bridge and Iron Company vs. Caterpillar Tractor* which was pending before the Supreme Court in January 1982.

We are not unmindful that the Treasury Department initiated, pursuant to the President's suggestion, a "Worldwide Unitary Taxation Working Group" which studied the problems and recommended solutions to the issues presented by Worldwide Unitary Taxation levied by several states and that further actions are being actively considered by your Department at this time. Nevertheless, our concern continues to grow not only as to the propriety of the continuation of this type of taxation by a few states, but as to the adverse impact upon Exxon that this may have upon our foreign operations as foreign

nations take action to retaliate against us for the tax indignities that their companies are experiencing in those states that impose Worldwide Unitary Taxation. For example, the British Parliament recently enacted stand-by retaliatory authority for their Treasury to invoke against United States' based multinationals. If such authority were exercised, the financial impact upon Exxon's competitive position vis-a-vis foreign-owned companies could be devastating. Similar type action undertaken by other major trading nations could effectively exclude us from a number of foreign markets.

Therefore, the three distinctions drawn by the *Container* Court between the facts in that case and the principles of *Japan Line* do not apply in the foreign parent case.

### 3. The Court Stated That *Container* Was An Exception To The Doctrine Of *Japan Line*.

Finally, there can be no doubt that this Court did not view the domestic parent situation to be a foreign commerce case because it explicitly stated that the *Container* case was within an exception of the foreign commerce principles enunciated in *Japan Line*:

The third difference between this case and *Japan Line* is that the tax here falls, not on the foreign owners of an instrumentality of foreign commerce, but on a corporation domiciled and headquartered in the United States. We specifically left open in *Japan Line* the application of that case to 'domestically owned instrumentalities engaged in foreign commerce', *id.* at 444, n. 7, and - to the extent that corporations can be analogized to cargo containers in the first place - this case falls clearly within that reservation.

463 U.S., at 188-89, footnote omitted.

Simply stated, the doctrine of *Japan Line* does not and was not intended to apply to the case of American parents because the ultimate impact of any burden was essentially domestic.

On the other hand, the locus of the burden in the foreign parent context is in foreign commerce and thus *Japan Line* applies.

### 4. Defendants' Actions Constitute A Burden On Foreign Commerce And Violate The Principles Expressed In *Japan Line*.

It is well established that matters of foreign commerce are the exclusive prerogative of the federal government. *Japan Line*, *supra* at 448. This Court has stated that when a state seeks to tax the instrumentalities of foreign commerce, two significant principles come into play. The first is the enhanced risk of multiple taxation if a state imposes a tax on activities in foreign commerce:

If an instrumentality of commerce is domiciled abroad, the country of domicile may have the right, consistently with the custom of nations, to impose a tax on its full value. If a State should seek to tax the same instrumentality on an apportioned basis, multiple taxation inevitably results.

441 U.S., at 447, footnote omitted.

In the case of the foreign parent, and as the facts of this case amply demonstrate, multiple taxation is inevitable as a practical matter. Moreover, this Court in *Japan Line* noted that when the risk of multiple taxation is "enhanced" by the state taxing scheme, the scheme is forbidden by the Commerce Clause:

When a State seeks to tax the instrumentalities of foreign commerce, two additional considerations, beyond those articulated in *Complete Auto*, come into play. The first is the enhanced risk of multiple taxation . . .

Due to the absence of an authoritative tribunal capable of ensuring that the aggregation of taxes is computed on no more than one full value, a state tax, even though "fairly apportioned" to reflect an instrumentality's presence within the State, may subject foreign commerce "to the risk of a double tax burden to which (domestic) commerce is not exposed, and

which the commerce clause forbids." *Evco v. Jones*, 409 U.S., at 94, quoting *J. D. Adams Mfg. Co.*, 304 U.S. at 311.

*Id.* at 446 & 447.

In *Container*, this Court noted that even the arms length method involved a risk of multiple taxation because any allocation system is imperfect; however, WCA as applied to foreign parents is more than simply imperfect<sup>21</sup>, it enhances the risk of multiple taxation to a level approximating certainty, and it enormously amplifies the impact of the multiple taxation.

In short, the quantitative impact of WCA in the foreign parent case is so much different than the arms length method that, for practical purposes, and certainly for the purposes of analysis under the *Japan Line* doctrine, it should be viewed as qualitatively different.

*Japan Line* also expressed the need for federal uniformity in areas of foreign commerce, stating:

Finally, in discussing the Import-Export Clause, this Court, in *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 285 (1976), spoke of the Framers' overriding concern that "the Federal Government must speak with one voice when regulating commercial relations with foreign governments." The need for federal uniformity is no less paramount in ascertaining the negative

<sup>21</sup> Although the arms length method is imperfect, that imperfection stems from its application, not its theory. The arms length method uses the marketplace to adjust for the vast differences between the economic realities of each country by measuring accounting results against the results of actual transactions at arms length. Where data is scarce or has not been obtained, the results will be imperfect. With WCA, however, imperfection is systemic because it simply ignores the vast differences in economic realities between countries. For example, under WCA it is assumed that a worker in Thailand makes the same income and produces the same value per dollar as employees in California. Such an assumption is absurd.

implications of Congress' power to "regulate Commerce with foreign Nations" under the Commerce Clause.

441 U.S., at 449 footnote omitted.

WCA applied to foreign parents forces the U.S. to speak with more than one voice. Moreover, when WCA is applied to foreign parents, one obvious consequence noted earlier is that the foreign parent is forced to undertake the administrative burden of complying with a federal tax scheme, notwithstanding the fact that the federal government agreed by treaty it would not impose such a burden on foreign parents operating in this country through subsidiaries. It is, therefore, not surprising that foreign governments would view the application of the WCA to their foreign parent corporations as the U.S. speaking with more than one voice.

The other method by which a tax could frustrate federal uniformity is:

If a novel [s]tate tax creates an asymmetry in the international tax structure, foreign nations disadvantaged by the levy may retaliate against American owned instrumentalities present in their jurisdictions.

463 U.S., at 450

Critical to the *Container* evaluation of the American parent was this Court's view that there was unlikely to be foreign retaliation. In this case, there already is the beginning of actual retaliation, and no wonder, when one considers the disadvantages imposed on foreign nations by the tax.

For example, as was illustrated earlier, the tax sanctions increase in productivity in foreign countries. In the Indian hypothetical on p. 23, *infra*, it was clear that the tax liability to California increases as the Indian company became more productive.

WCA also makes many foreign investments more expensive. For example, many countries require that foreign investors share ownership with the state or with host country nationals. Since WCA pulls into the tax base

the *total* income of a subsidiary, even if ownership is only 51% and because the tax is collected from the American subsidiary, the foreign parent must bear that portion of the tax attributable to the 49% owners of companies whose income was apportioned to the Respondent's tax base (Stip. #46, JA at 97). This, therefore, raises the cost of investments which a Canadian company might wish to make, for example, in Mexico.

Another disadvantage of WCA is that it imposes sanctions on the exploitation of cheap and abundant resources outside of California. For example, to the extent that Respondent is able to find cheaper and more abundant sources of raw materials, such as bauxite, outside of California, tax liability to California rises. This results from the fact that the lower the cost of the capital and labor required for the exploitation of the resources, the more the formula will impute income to California thereby raising the cost to Respondent of utilizing these resources.

Thus, it is clear that WCA as applied to foreign parents acts as a method for penalizing those parents for undertaking activity outside the U.S. that is economically more attractive than the same activity in California. Therefore, there is no wonder that foreign governments have been so enraged by the tax, and that the United Kingdom is prepared to retaliate.<sup>22</sup> Clearly, WCA as applied to foreign parent combinations frustrates federal uniformity.

Finally, the Federal government has expressed in no uncertain terms its view that this tax has interfered with its ability to conduct foreign commerce. Secretary of the

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<sup>22</sup> This Court should not be lulled into complacency because actual retaliation has not occurred. International restraint has been exercised because of the recognition of the catastrophic consequence of retaliation and the difficulty of stopping it.

Treasury Baker in a December 18, 1985, letter to the then Speaker of the House Thomas P. O'Neill, Jr. stated:

The practice of a small, but important minority of the states of assessing corporate income tax on a worldwide unitary basis has caused serious difficulties with the conduct by the federal government of our foreign economic policy. Virtually all of our major investment partners have objected to state practice in this regard. They point out that the worldwide unitary method departs from the principles of international taxation generally followed in the international community and by the federal government. Furthermore, they claim that imposition of the unitary method on their U.S. subsidiaries creates serious administrative burdens in obtaining and converting to U.S. standards accounting information on the foreign affiliates of the unitary group. Finally they argue that the use of the worldwide unitary method may lead to double taxation of the foreign source income of these foreign affiliates. We agree with these contentions. These objections have resulted in the adoption of enabling legislation by the United Kingdom permitting serious retaliatory measures to be taken against U.S. companies. It has become clear that the ability of the federal government to speak with one voice in the conduct of foreign economic affairs is significantly weakened because of these state practices.

Alcan's 7th Circuit Brief, Exhibit K, p. 1

The burden imposed by WCA on Respondent and other foreign parents is unmistakable. AlcanCorp is not making bauxite investments or operating in Mexico, Respondent is and its ability to conduct these affairs without considering the direct economic impact on its investment in the U.S., which directly burdens it and causes the tax to be unconstitutional and gives rise to standing.

### III. THERE IS NO SERIOUS ISSUE AS TO THE APPLICATION OF THE TAX INJUNCTION ACT OR COMITY THAT APPLY IN THIS CASE.

#### A. THERE IS UNANIMITY AMONG THE CIRCUITS THAT THE TAX INJUNCTION ACT DOES NOT APPLY TO THIS CASE

The Petitioners attempt to resurrect the argument that has, except for one early, subsequently reversed, district court opinion, been a consistent series of losses and that is that the Tax Injunction Act explicitly bars this case. In some convoluted manner, the Petitioners cite as authority a case in which a State is the plaintiff, has no direct remedy of its own and avoids the impact of a similar statute with respect to federal taxes. One would think that such a holding would support Respondent's series of successes on this issue. Equally puzzling is the final case they cite, *Norman v. Consolidated Edison Co. of New York*, 89 F.2d 619 (2d Cir. 1937), which the Petitioners agree was effectively reversed by this Court later the same year in a similar case.

In sum, after claiming "conflict with past authority", the Petitioners simply cite a series of cases whose outcomes simply confirm the decision of the Seventh Circuit. It is undisputed that Respondent has no remedy and, therefore, it is equally clear that the Act does not apply. Nor was Petitioners' failure to give Respondent a remedy an oversight. When questioned, Petitioners made it quite clear that they would never grant Respondent a remedy because in their view the tax imposed no foreign commerce burden.<sup>23</sup>

<sup>23</sup> The Seventh Circuit notes: "It is also significant that California presumably possesses a ready remedy for unwanted federal intrusion. . . . With such an effective means of self-help for the state so near at hand, we cannot conclude that comity requires us to deny plaintiffs the opportunity to appear as named parties to litigate their constitutional claims." 860 F.2d, at 699.

#### B. COMITY AND THE POLICY UNDERLYING THE TAX INJUNCTION ACT DO NOT COMPEL THE APPLICATION OF THE TAX INJUNCTION ACT

In an apparent effort to find some legal doctrine under which to deny standing the Petitioners, in an act of desperation, seem to lapse into a general discussion of the policy of the Tax Injunction Act:

If federal standing is not to be so limited, will the federal courts be deluged with the suits filed by domestic companies which are dissatisfied with the state tax treatment of their subsidiaries? *Meanwhile, what happens to the spirit, if not the letter of the Tax Injunction Act?*

Petition for writ, at 18 (emphasis added).

There is some authority for the proposition that comity and federalism might under the proper circumstances, cause a federal court to defer federal action. The Seventh Circuit expressly considered and rejected the application of that doctrine for two reasons. First, the absence of a remedy to the directly injured party, and second, the balancing of federal comity against international comity. Respondent would urge that a third reason compels federal action and that is federal comity itself.

The fact that Respondent has no cause of action has important practical implications. The corollary to this proposition is that even if AlcanCorp has a remedy it is practically not as effective.<sup>24</sup> A suit by AlcanCorp on the foreign commerce issue is a suit by AlcanCorp in name only. This is perhaps best illustrated in the context of a

<sup>24</sup> The Seventh Circuit's reasoning proceeded on the assumption that AlcanCorp did have a remedy in the State Court. In fact, that issue is in serious doubt. California's Code of Civil Procedure; § 367 specifically states that civil actions must be prosecuted in the name of the "real party in interest". If the injury is the effective deprivation of the use of a subsidiary as a vehicle for the conduct for foreign commerce, there is but one real party in interest, the Respondent.

non-wholly owned foreign subsidiary, where the foreign parent is a 51% owner. Thus, the subsidiary is subjected to WCA, and the remaining 49% is owned by U.S. nationals. Clearly, the U.S. interests would have little ability and little interest in sharing the economic burden of litigating a foreign commerce burden. Forcing the American interests to litigate the interests of the foreign owner is clearly litigation by surrogate.

The second reason offered by the Seventh Circuit is the balancing of international comity with federal comity. By this, we understand the Seventh Circuit to be saying that it has to abide by the expectations of the foreign nations, as well as states, and that these nations would object to no access for their citizens in any form, a situation which would hardly outweigh matters of convenience of state administration, especially when the state created the problem.

Third, we believe that federal comity itself requires federal intervention. This is not the typical matter where the only issue is federal review of state action, such as a Due Process challenge. Instead this is a matter involving state intrusion into an area specifically mandated to the federal government. It is Respondent's position that where states intrude on sensitive areas that are constitutionally mandated to the exclusive province of the federal government the comity principles of federalism mandate federal priority.

**C. THE CONCERNS OF THE AMICI OF THE PETITIONERS ARE, TO THE EXTENT THEY ARE ASCERTAINABLE, DISTINGUISHABLE FROM THIS CASE**

The Amici in support of the Petitioners fall into two categories. The two briefs filed on behalf of various states, directly and through their Association, make two points. The first is that they have no interest in the merits of the unitary tax issue, and the second is that, as a result of the Seventh Circuit's ruling, they perceived some deluge of litigation in the federal courts. Respondent was particularly interested in these briefs because, as we had

argued, the standing question was uniquely tied to the merits of the unitary tax case, and the ability to apply this doctrine indistinguishably to other situations would be troublesome. If there is any blatant hole in the arguments of these amici, it's the fact that they are unable to give one example of the application of the principles enunciated by the Seventh Circuit beyond the unitary context. They give a thorough list of all the black letter rules, the same black letters rules that the Petitioners recite. The problem is that they do not illustrate how the Seventh Circuit violated those rules in such a way that would give rise to a situation on which they might have some legitimate concern outside of the unitary context. Perhaps we are lucky that they are only amici since no one will have the opportunity to ask them for an example, and we would all be embarrassed by the deafening silence of the response.<sup>25</sup>

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<sup>25</sup> One Amicus, the group of Associations, suggest this is a case of "forum shopping." That claim is not supported by the facts. Respondent would welcome its own opportunity to litigate in the state court since the existence of such an opportunity would effectively resolve the constitutional issue in Respondent's favor. Moreover, this Amicus failed to answer the question, shopping for what? In forum shopping, one is usually looking for a forum which has not already resolved the issue adversely. We know of no such decision in the California State Courts, and see no reason why the California State Courts were more or less likely to rule against the foreign parent. On the contrary, in *Barclay's Bank Int'l Ltd. v. Franchise Tax Board*, Calif. Sup. Ct. No. 325059, a case that does not even involve a subsidiary method of operation, the foreign parent prevailed in the California Courts. There, of course, Barclay was also the taxpayer, so it had its own remedy. Finally, since this issue (however and whomever was going to resolve it), was clearly not one that would languish for any period without review by this Court, one could hardly make a national case for going into the federal system with all the attendant problems, such as abstention, the Tax Injunction Act standing, etc., without some important objective. That objective was to insure that *its* case about *its* injuries was before the Court.

Perhaps the biggest surprise is the Amicus brief of the Multistate Tax Commission ("Multi"). Framed as supporting Petitioners, Respondent could have hardly done a better job if it had written the section on standing itself. It has been the gravamen of this case that the merits of the constitutional issue and standing were inextricable. Rule on one and you rule on the other. Imagine our surprise when we see Multi making the same point, perhaps inadvertently, but then again the truth does have the nasty habit of sneaking out when least expected:

[Y]our *Amicus* submits that the indirect and derivative nature of the claimed injuries of Alcan and Imperial establish that these injuries are inextricably intertwined with the issues presented by the subsidiaries in their pending state refund proceedings.

Amicus Brief of the Multistate Tax Commissioner, at 13.

Of course, the only issues in the state refund action are the constitutional issues, and we agree they are inextricably intertwined with the issue of whether we are directly or indirectly injured. Predictably, the remainder of that section deals with the merits of the unitary issue.

#### IV. CONCLUSION

For all of the foregoing reasons, the decision of the Seventh Circuit Court of Appeals should be affirmed.

Respectively submitted,

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**COUNTER STATEMENT OF  
QUESTION PRESENTED**

Whether a foreign corporation that is denied access to State courts should have standing in federal court to present claims of independent injury arising from a direct conflict of State tax policy with federal foreign commerce policy.

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No. 88-1400

IN THE

**Supreme Court of the United States**

OCTOBER TERM, 1988

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FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA; LEONARD  
WILSON, Individually and as District Manager, Chicago Office  
of the Franchise Tax Board of the State of California; and B.  
M. RARANG, Individually and as Auditor, Chicago Office of  
the Franchise Tax Board of the State of California,

*Petitioners,*

v

IMPERIAL CHEMICAL INDUSTRIES PLC,

*Respondent.*

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**ON WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS  
FOR THE SEVENTH CIRCUIT.**

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**BRIEF FOR RESPONDENT IMPERIAL CHEMICAL  
INDUSTRIES PLC**

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**INTRODUCTION**

This case is before the federal courts because the State of California imposes a unique tax regime that inflicts economic burdens on foreign nationals in contradiction of federal economic foreign policy. California, through its Franchise Tax Board, *assesses* foreign source income of foreign persons by defining "taxpayer" to include a multinational group of corporations, wherever domiciled or operating, without regard to national sources of income. California *collects* the

tax thereby assessed from that member of the group found in California. This regime impugns the integrity of United States tax treaties with foreign nations and has engendered international protests. The foreign "taxpayer" upon which the economic burden falls is denied access to California courts. Because denial of access to federal courts by foreign parents of multinational groups injured by California's tax regime is, effectively, denial of access to any court, Imperial should have standing. That is all the Seventh Circuit Court of Appeals decided in this case and that decision should be sustained by this Court.

### COUNTER STATEMENT OF THE CASE

*Proceedings Below.* Respondent Imperial Chemical Industries PLC<sup>1</sup> ("Imperial") filed an action in the United States District Court for the Northern District of Illinois against the Petitioners, the Franchise Tax Board of the State of California and the manager and auditor of their Chicago office ("Board"), seeking declaratory and injunctive relief in respect of California income tax assessments. Joint Appendix ("JA") 2, 16. A complaint seeking similar relief based on different facts had been filed previously in the same court by Alcan Aluminium Ltd ("Alcan"). JA 1, 6. The Board filed separate motions to dismiss each complaint on the ground that neither plaintiff had standing to maintain its action in federal court. JA 1, 2, 13, 23.

The district court ruled that Alcan's allegations, if proven, would confer standing and ordered the Board to answer. JA 1, 26. The Board thereafter withdrew the motion to dismiss Imperial. JA 2, 30. The district court then entered a "finding of relatedness" of Imperial's case to Alcan's and assigned both cases to the same judge. JA 2. The Board filed a separate answer to each complaint. JA 1, 2, 31, 34. Both cases were then reassigned to a different judge. JA 1, 2.

<sup>1</sup> The names of corporations affiliated with Imperial that are not wholly-owned subsidiaries are listed in Appendix 1 to Imperial's Brief in Opposition ("Br. Opp."). The worldwide group of companies owned or controlled by Imperial, including wholly-owned subsidiaries, is referred to herein as the "Imperial Group."

On 3 January 1986, Imperial filed a motion for summary judgment together with the summary statement of facts required by district court rule 12(e) in civil actions. JA 3, 103, 105. The Board filed a cross motion for summary judgment on grounds the district court lacked jurisdiction to entertain Imperial's action. JA 3, 135. The Board did not request findings of fact. A similar motion was filed in the related (Alcan) case. JA 3, 133.

On 30 July 1987, the district court granted the Board's motion to reconsider the prior order respecting standing and dismissed each case for lack of standing. JA 4; Appendix to Petition ("PA") A-25—A-27. The district court's opinion makes no findings of fact and makes no reference to the record.

Imperial and Alcan filed separate appeals to the United States Court of Appeals for the Seventh Circuit. JA 2, 4. The court of appeals found that both appellants had "alleged injuries resulting from California's franchise tax that are sufficiently direct and independent of the injuries to their subsidiaries to confer standing." Each case was remanded to the district court for further proceedings.<sup>2</sup>

*Imperial's Facts.* The worldwide combined income apportionment formula or "unitary method" used by the Board determines the amount of a taxpayer's income attributable to and taxable by California. Under this method, all business activities of commonly controlled corporations that the Board deem to function as a "unitary" business are combined. The combined income is apportioned by a three-factor formula that compares activities conducted in California to activities of the "unitary" business everywhere. JA 46, 47.

For income years 1971 through 1981, ICI Americas Inc. ("Americas"), a wholly owned, U.S. subsidiary of Imperial, filed California franchise (income) tax returns. Americas reported net income apportioned to California by the three-factor formula, using California property, California payroll, and California sales of Americas as numerators and all prop-

<sup>2</sup> *Alcan Aluminium Ltd v Franchise Tax Board*, 860 F.2d 688 (7th Cir. 1988); PA A-1.

erty, all payroll, and all sales of Americas as denominators. JA 43.

For income years 1971 through 1981, the Board audited the California franchise tax returns of Americas. JA 46. Board auditors demanded information relating to consolidating entries of Imperial; intercompany transactions of the Imperial Group; data on worldwide rentals; worldwide property detail; worldwide construction in progress; worldwide payroll detail; and worldwide sales of the Imperial Group. JA 53, 115; Ex. 8, 9, 11, 12.<sup>3</sup> The auditors also sought information on worldwide research facilities and expenditures of Imperial and its subsidiaries. Ex. 8. The auditors requested "a breakdown of the California inventory and property at original cost in historical English pounds." JA 111; Ex. 12. Americas personnel supplied all information within their possession but requested the Board to contact the London office of Imperial for worldwide information that was not in the possession of Americas. JA 111; Ex. 10. Much of the information requested is outside the scope of Imperial's accounting records. JA 54; Ex. 9.

The Board determined that Americas was part of a single, worldwide, unitary enterprise conducted by all members of the Imperial Group. Based upon this determination, the Board recomputed income subject to California tax using as the apportionment base the assumed worldwide income of the Imperial Group. JA 46.

For most of the audit years, substantial increases in Americas' California tax liability resulted from the Board's determinations that Americas was part of a "unitary" business conducted by the Imperial Group and that use of worldwide combined income apportionment was required to determine properly California taxable income. JA 51.

In computing the Imperial Group's income apportionable to California, the Board began with consolidated income of the Imperial Group shown in the financial statements in Imperial's published annual reports, expressed in pounds

<sup>3</sup> "Ex." refers to exhibits accompanying the district court record.

sterling. Adjustments based on information contained in the published annual reports were made by the Board purporting to eliminate exchange rate gains and losses and earnings of corporations owned fifty percent or less by Imperial. Adjustments were also made by the Board to earnings of Imperial purporting to conform the statements to California tax accounting principles. JA 51.

The California apportionment factor was calculated by averaging the three-factor fractions expressed in pounds. To obtain these fractions, numerators expressed in U.S. dollars were supplied to the Board by Americas. These amounts were converted by the Board to U.K. sterling (pounds), using average exchange rates for the year published by the International Monetary Fund. JA 51-52. Denominators of the three fractions expressed in pounds were derived by the Board from Imperial's annual reports. JA 52.

The apportionment factor determined above was then multiplied by the worldwide business income of the Imperial Group shown in the annual reports of Imperial. The result, in pounds, was deemed business income apportioned to California, and was translated into dollars at the International Monetary Fund average exchange rates for the year. The California tax was calculated by applying the current statutory rate to such apportioned income. JA 52.

It is anticipated that assessments for years after 1981 are likely to be proposed by the Board on the same worldwide, combined, Imperial Group income basis as in earlier years. JA 53, 54.

There are significant differences in accounting principles and reporting practices among the United Kingdom and the various nations, including the United States, in which the Imperial Group conducts business. JA 55; JA 117. A major accounting problem involves conversion of transactions from one foreign currency to another. JA 117; Ex. 15.

Imperial projects that the additional administrative cost of preparing California franchise tax returns using worldwide combined income apportionment for the Imperial Group will

be £ two million initially, plus £ two million annually. The cost of reporting and making accounting adjustments required to conform worldwide information to California accounting includes the cost of maintaining a set of records for the Imperial Group to conform to California tax accounting rules and the cost of translating transactions of foreign subsidiaries first to pounds and then to dollars. JA 58; Ex. 22.

Under United Kingdom law, a resident corporation is entitled to (direct) credit for foreign taxes paid on dividends from subsidiaries in overseas countries, and to (indirect) credit for foreign income taxes paid on earnings out of which dividends are distributed. United States federal income taxes and California franchise taxes may qualify for the United Kingdom indirect credit, subject to two limitations: (a) No credit can be obtained for dividends paid from years in which the dividend paying subsidiary records a net book loss; and (b) no credit is allowable in excess of the amount of United Kingdom tax exigible on the dividends paid. JA 57; Ex. 19.

Americas incurred book losses for income years September 30, 1972 (\$6,819,633); September 30, 1973 (\$27,434,974), and December 31, 1975 (\$2,038,420). JA 45. Americas was assessed California taxes for these years based on apportionment of Imperial's worldwide income, respectively, of \$72,956 (1972); \$112,966 (1973); and \$42,011 (1975). JA 48.

Where taxable income of a U.S. subsidiary corporation of a U.K. company is increased over its book income by worldwide combined income apportionment, the effective California tax rate for U.K. tax credit purposes is increased, since only book income of the U.S. subsidiary may be taken into account when computing the amount of foreign tax subject to U.K. credit. JA 118-119; Ex. 19.

Application of the worldwide combined income apportionment formula to determine California taxes of subsidiaries of foreign corporations that, like Imperial, have no connection with California except through commerce with a subsidiary doing business in California, has resulted in in-

creasingly vigorous objections from the nations that are major trading partners of the United States. JA 55-56; Ex. 17. From 1980 through 1984, the United States Department of State and Department of the Treasury received communications from the governments of the United Kingdom, Canada, Australia, The Netherlands, Belgium, Switzerland, West Germany, Japan, and the member states of the European Community. Ex. 17 (parts 1 through 14). These statements objected to worldwide combined income apportionment, such as used by California, on grounds of double taxation, costs of compliance, interference with foreign commerce, and failure of the United States Government to speak with one voice in foreign affairs. JA 120-121; Ex. 17.

In 1985, the United Kingdom enacted standby legislation authorizing their treasury to withdraw substantial United Kingdom tax credits from United States companies domiciled in or having 7.5% or more of their property, payroll, or sales in a State requiring worldwide combined income reporting. JA 57, 120-121; Ex. 18.

## SUMMARY OF ARGUMENT

The decisions of this Court in *Japan Line, Ltd. v County of Los Angeles*,<sup>4</sup> and *Container Corp. v Franchise Tax Board*,<sup>5</sup> establish that a State tax on an instrumentality of commerce owned by a foreign corporation is prohibited by the commerce clause if it interferes with the ability of the United States Government to "speak with one voice" in foreign affairs or presents a risk of double taxation. The instant case arises from the manifest conflict between federal foreign economic policy and California's unitary tax policy as administered by the Board. Imperial is within the class of persons intended to be protected by federal foreign economic policy and can demonstrate injury to its own commerce by the Board's actions. California does not provide a forum in which Imperial can make its claim of injury to its own commerce by the Board's actions. The remedy sought and the decision

<sup>4</sup> 441 U.S. 434 (1979)

<sup>5</sup> 463 U.S. 159 (1983)

of the court of appeals, below, do not create a risk of interference with normal State collection procedures. Neither principles of federal abstention, comity, nor the Tax Injunction Act should, therefore, bar Imperial's action in federal court.

## ARGUMENT

### I. IMPERIAL IS THE PROPER PARTY TO INVOKE PROTECTION OF FEDERAL FOREIGN COMMERCE POLICY THAT CONSTITUTIONALLY OVERRIDES CALIFORNIA'S UNITARY TAX POLICY.

The injuries alleged by Imperial as grounds for standing are precisely the injuries alleged by Imperial as grounds for relief on constitutional principles. The standing issue, therefore, directly implicates the conflict between federal foreign economic policy and California's unitary tax policy. Accordingly, the constitutional limits on the Board's unitary method of taxation and the federal foreign economic policy to which that unitary method must yield are first addressed.

#### A. THE CONSTITUTION PROHIBITS CALIFORNIA'S INTERFERENCE WITH FEDERAL FOREIGN COMMERCE POLICY.

Constitutional limits on the power of the States to tax enterprises with worldwide business have been addressed in a series of Supreme Court decisions beginning with the case most relevant here, *Japan Line*.<sup>6</sup> That case established the proposition, reaffirmed in *Container Corp.*,<sup>7</sup> that a State tax on instrumentalities of commerce owned by a foreign corporation is prohibited by the Commerce Clause if it limits the ability of the United States Government to speak with one voice in foreign affairs or presents a risk of double taxation.

In *Japan Line*, Los Angeles County asserted a property tax on shipping containers owned by a Japanese company

<sup>6</sup> See *infra* p. 7, n. 4. Other relevant cases are *Mobil Oil Corp. v. Commissioner*, 445 U.S. 425 (1980); *Exxon Corp. v. Wisconsin Dept. of Rev.*, 447 U.S. 207 (1980); *ASARCO Inc. v. Idaho State Tax Comm.*, 458 U.S. 307 (1982); and *F.W. Woolworth Co. v. Taxation and Rev. Dept.*, 458 U.S. 354 (1982).

<sup>7</sup> See *infra* p. 7, n. 5.

that were temporarily located in the county on the tax lien date. In ruling that the tax was prohibited by the Commerce Clause, this Court held that burdens on foreign commerce are subject to limitations not applicable to interstate commerce:

The premise of appellees' argument is that the Commerce Clause analysis is identical, regardless of whether interstate or foreign commerce is involved. This premise, we have concluded, must be rejected. When construing Congress' power to "regulate Commerce with foreign Nations," a more extensive constitutional inquiry is required.

[441 U.S. at 446.]

*Japan Line* carefully reserved judgment on the taxability of "domestically owned instrumentalities engaged in foreign commerce."<sup>8</sup> That issue came before this Court in *Container Corp.*, which involved application of California's worldwide unitary apportionment to a domestic parent corporation with foreign subsidiaries. This Court held the tax not to be prohibited by constitutional limitations, but in so doing, this Court nevertheless affirmed the constitutional standard stated in *Japan Line*:

If the unitary business consisting of appellant and its subsidiaries were entirely domestic, the fact that different jurisdictions applied different methods of taxation to it would probably make little constitutional difference . . . . Given that it is international, however, we must subject this case to the additional scrutiny required by the Foreign Commerce Clause. [Citation omitted] The case most relevant to our inquiry is *Japan Line*.

[463 U.S. at 185.]

This Court concluded that *Japan Line* was distinguishable on essentially two grounds. The first was that the property tax in *Japan Line* necessarily resulted in double taxation, whereas double taxation of the income of a multinational business results from combination of different methods

<sup>8</sup> 441 U.S., n. 7 at 444.

of allocation and thus depends solely on the facts of the individual case.<sup>9</sup>

The second distinction was that in *Japan Line* the economic burden of the tax fell on the foreign owner, not on a United States corporation.<sup>10</sup> The opinion emphasized this second ground by expressly reserving decision on factual circumstances of a case such as *Imperial's*:

We have no need to address in this opinion the constitutionality of combined apportionment with respect to state taxation of domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries.

[463 U.S., n. 26 at 189]

The issue reserved by this Court in *Container Corp.* is the fundamental issue in the present case: Does federal foreign commerce policy, which is granted supremacy under the Commerce Clause, prohibit the Board's application of the worldwide combined income apportionment formula to a foreign parent corporation and its worldwide subsidiaries?

Under principles established in *Japan Line* and *Container Corp.*, the tax asserted by the Board in the present case is prohibited by the Constitution because it simultaneously involves risk of double taxation and limits the ability of the United States Government to speak with one voice in foreign affairs.<sup>11</sup>

B, THE BOARD'S UNITARY TAX METHOD CONFLICTS DIRECTLY WITH ESTABLISHED FEDERAL FOREIGN COMMERCE POLICY.

1. *The Arm's Length Separate Accounting Method of Taxation is a Federal Foreign Economic Policy.* This case is before this Court because California's worldwide, unitary,

<sup>9</sup> 463 U.S. at 188.

<sup>10</sup> *Ibid.*

<sup>11</sup> JA 57; Ex. 17-1 through 17-14; Ex. 18. See also *amicus curiae* brief, submitted in district court by the United States Department of Justice, pp. 17-23 ("DoJ brief").

combined income assessment method<sup>12</sup> cannot be reconciled with the nearly universal acceptance of the arm's length method. That method treats related corporations as separate, economic entities and requires them to deal with one another on the same basis as they deal with unrelated parties. Taxable income is determined by separate accounting for each of these entities provided they observe the arm's length principles.

Federal foreign policy and, to a large extent, foreign commerce policy are Executive prerogatives. The Executive has firmly embraced and promoted the arm's length method. In recommending legislation to Congress that would prohibit use of worldwide unitary taxation, the Secretary of the Treasury stated unequivocally that the Executive agreed with the contentions of the foreign governments respecting States' use of worldwide unitary taxation and that, "It has become clear that the ability of the federal government to speak with one voice in the conduct of foreign economic affairs is significantly weakened because of these state tax practices."<sup>13</sup> In this very case, Executive support of the arm's length method was clearly stated by the United States.<sup>14</sup>

Congress has affirmed the use of the arm's length separate accounting method in two ways. Congress has ratified tax treaties between the United States and its trading partners which incorporate the arm's length method. The United States—United Kingdom Income Tax Convention of 1975,<sup>15</sup> like all other United States tax treaties, plainly establishes the "arm's length standard" of international taxation—as contrasted with California's unitary tax method—through the following provision:

The business profits of an enterprise of a Contracting State shall be taxable only in that State unless

<sup>12</sup> California is virtually alone among the fifty States and alone in the world in applying worldwide, unitary, combination. All but four States—Alaska, California, Montana, and North Dakota—have now abandoned worldwide unitary taxation. Montana does not apply the method to foreign parent multinationals. Alaska appears to apply the method only to domestic parents and foreign parent oil companies.

<sup>13</sup> JA 124.

<sup>14</sup> DoJ brief p. 22-23.

<sup>15</sup> 31 U.S.T. 5668, T.I.A.S. 9682.

the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. [Art. 7(1)]

The definition of a "permanent establishment" (Art. 5) does not include a subsidiary corporation unless it operates as a branch of the foreign parent. The foreign parent's foreign source profits, hence, are not taxable in the subsidiary's domicile.<sup>16</sup> This arm's length result is exactly the opposite of California's unitary method.

Congress has enacted federal tax laws that establish federal tax policy with respect to foreign commerce. The arm's length separate accounting method is embodied in Internal Revenue Code<sup>17</sup> ("Code") § 482 and the regulations thereunder as well as in the income sourcing rules of Code §§ 861, 862, and 863. Dividends received from a foreign corporation are treated as foreign source income unless 25% or more of the foreign corporation's income is "effectively connected" with the conduct of a trade or business in the U.S.A. by such foreign corporation. The Code, in addition, grants foreign tax credit to dividends received from foreign corporations, both for foreign withholding taxes on such dividends (§ 901) and for taxes on the underlying income that produced such dividends (§ 902). Since the laws of the United Kingdom and other treaty partners contain similar provisions with respect to foreign dividends paid to their own nationals, it is beyond dispute that the arm's length method is the internationally recognized norm as well as the United States norm. This was the basis for the numerous protests of record<sup>18</sup> by foreign governments as well as the statements by the President and the Secretaries of State and Treasury

<sup>16</sup> The Board argued in the district court that failure of the necessary two-thirds of the United States Senate to accept the United Kingdom Tax Convention's express prohibition against States' use of unitary taxation demonstrates Congressional intent to permit States to use the method internationally. But not enacting a prohibition is altogether different from granting permission. A majority of the Senate actually approved the prohibition and the arm's length standard remains embodied in tax treaties later adopted as well as in the Internal Revenue Code.

<sup>17</sup> Tit. 26 U.S.C.

<sup>18</sup> See *infra* pp. 6-7.

opposing California's international application of the unitary tax method.<sup>19</sup>

2. *Protection of Direct Foreign Investment Through a Domestic Subsidiary is a Federal Foreign Economic Policy.* For many years the federal government has by treaty, statute<sup>20</sup> and administrative action<sup>21</sup> fostered foreign direct investment in the United States and encouraged United States persons similarly to invest abroad. The United States—United Kingdom Income Tax Convention<sup>22</sup> illustrates the treaty protections that are offered reciprocally to foreign investors who choose to establish domestic subsidiary corporations in the United States. Similar provisions are found in U.S. tax treaties with many other trading partners within the Organization for Economic Cooperation and Development (OECD).<sup>23</sup> The more important provisions are:

(a) The subsidiary files U.S. tax returns reporting only its own income. The U.K. parent does not have to file U.S. income tax returns and pays no U.S. taxes on income that is not "effectively connected"<sup>24</sup> with U.S. operations. [Art. 7.]

(b) If 10% or more of the capital stock of the subsidiary is owned by a U.K. parent, double taxation of dividends is eliminated through granting reciprocal tax credits for income taxes paid on the subsidiaries' income from which dividends are paid. [Art. 23.]

(c) Where countervailing income adjustments are made by the respective (U.S.—U.K.) tax authorities that result in double taxation, a "competent authority" procedure is established to determine which nation has

<sup>19</sup> JA 122-124; Ex. 23; Ex. 24.

<sup>20</sup> This foreign economic policy has been firmly established by statute since enactment of the Foreign Investors Tax Act, Tit. I, P.L. 89-809, 89th Cong. 2d Sess. (1966), 80 Stat. 1539.

<sup>21</sup> DoJ brief pp. 18, 19, and Exhibit A; JA 122-125.

<sup>22</sup> See *infra* p. 11, n. 15.

<sup>23</sup> Principally, Australia, Canada, Federal Republic of Germany, France, Italy, Japan, The Netherlands, and United Kingdom.

<sup>24</sup> As defined in INT. REV. CODE § 864(c) and the U.S.—U.K. Income Tax Convention.

the primary right to tax the income in question and to relieve the double tax effect. [Art. 25.]

Based on these standard treaty provisions,<sup>25</sup> a foreign corporation may insulate its own income from U.S. (federal) tax if it chooses to operate through a separately incorporated, U.S. subsidiary.<sup>26</sup> Reciprocal protection is granted to a U.S. company operating through a subsidiary in the U.K. Because California's tax regime directly contravenes this protection, an international conflict has arisen.

3. *Taxation Based on Origin of Income is a Federal Foreign Economic Policy.* Both the treaties and the Code create a primacy of origin rule for taxing income. That is, income should be first taxed in the nation in which it was earned and should not be taxed a second time in the nation to which it is paid as a dividend except incrementally where the tax rate in the recipient's domicile exceeds the rate in the payor's domicile.<sup>27</sup> California's unitary method ignores this rule; gives no credit for foreign taxes paid on foreign source income; is unable to provide any equivalent to the "competent authority" procedure; and imposes both tax and compliance burdens on international enterprises that extend far beyond any conceivable nexus with California or, for that matter, the United States.

<sup>25</sup> Similar encouragement and protection is given by provisions granting exemption from withholding taxes to interest on debt (Art. 11) and royalties for the licensing of intellectual property (Art. 12).

<sup>26</sup> INT. REV. CODE §§ 861, 862, 884.

<sup>27</sup> E.g., U.S. Model Income Tax Treaty Convention of June 16, 1981, 1 CCH Tax Treaties ¶153; INT. REV. CODE §§ 861, 862, 901, 902.

### C. IMPERIAL SUFFERS SPECIFIC DIRECT AND INDEPENDENT INJURIES FROM CALIFORNIA'S INTERFERENCE WITH FEDERAL FOREIGN ECONOMIC POLICY.

1. *The Specific and Direct Injuries.* As a foreign investor having chosen to operate through direct investment in a U.S. subsidiary, Imperial is clearly within the class of intended beneficiaries of the federal economic policy and is entitled to the protection of the accord negotiated between the United Kingdom and the United States. The Board acknowledge that the legal principle by which this case must be decided is well established: Imperial has standing if it shows that it suffers some direct injury which is independent of those suffered by Americas.<sup>28</sup> The Board's actions create three specific burdens for Imperial: Economic double taxation; excessive cost of compliance; and unwarranted intrusion into fiscal decision making. These are described following:

(a) *Economic Double Taxation.* Economic double taxation results when the recipient of dividend income cannot obtain a credit in its nation of domicile for foreign taxes paid by the subsidiary that earned the income. In the instant case, the United States and the United Kingdom avoid this result by similar foreign tax credit provisions. Reciprocal credits are provided Under Art. 23 of the U.S.—U.K. Tax Convention.<sup>29</sup> The Board completely misconstrues the nature of the economic double taxation of which complaint is made: "Obviously, if the asserted taxes are measured in part by income earned and taxed elsewhere, it is the corporate taxpayers [Americas] which must bear the burden of the resulting double taxation."<sup>30</sup> This is entirely beside the point. The burden complained of here is borne by Imperial.

Imperial can *never* obtain U.K. tax credit for the California tax assessed and collected for the three loss years of Americas, 1972, 1973, and 1975.<sup>31</sup> The reason, as explained in the affidavit from the Inland Revenue Solicitor,<sup>32</sup> is that

<sup>28</sup> Petitioner's Brief ("Pet. Br.") pp. 22-23.

<sup>29</sup> See *infra*, p. 11, n. 15; p. 13, ¶(b).

<sup>30</sup> Pet. Br. p. 37.

<sup>31</sup> JA 44.

<sup>32</sup> JA 118-120; Exhibit 19.

U.K. credits are only available for foreign taxes paid in years in which income is earned by the subsidiary. Since California imposed taxes on income that Americas didn't earn under the international arm's length standard applied by the United Kingdom, no credit for those California taxes can ever be claimed by Imperial. The income that was taxed belonged to other members of the Imperial Group that had no connection with California. The results of these three years illustrate economic double taxation in its purest form. Americas is taxed by California on *deemed* income and the actual recipient of that income, Imperial, cannot get relief for the California tax against income that the U.K. clearly has the superior right to tax under the 1975 Convention.

Similarly, with respect to years in which Americas had income, the amount of U.K. tax credit that will be available to Imperial for California taxes will be reduced proportionately by the amount of foreign income the unitary formula apportions to California. If the foreign income is large and Americas' California income is small, the incidence of further double taxation necessarily increases. Americas pays California tax on income earned by and taxed to the Imperial Group.<sup>33</sup> While Imperial may claim U.K. credit for the foreign taxes on that same worldwide income, Imperial gets no U.K. credit for the California tax. The California tax, in effect, becomes a discriminatory tax imposed on U.S. source income by reason of including in the tax base foreign source income that is exempt from federal tax.

(b) *Excessive Costs of Compliance.* Compliance with the Board's worldwide combined income reporting requirement by a foreign parent multinational enterprise involves record-keeping that is quite extraordinary for the normal course of business, a fact that is recognized by the Board's regulations 25137-6(e)(1).<sup>34</sup> The Board's information requests to Americas demand a great deal of foreign data which, if

<sup>33</sup> Since Imperial is deemed a "taxpayer" with capital invested in California and payroll in California, its foreign source income is subjected to California tax assessment even if no sales are made into California. CAL. REV. & TAX. CODE §§ 25101, 25121, 25128.

<sup>34</sup> Appendix 1, *infra*, reproduces Reg. 25137-6 in full.

available at all, could only come from Imperial.<sup>35</sup> In order to comply fairly with the Board's information requests, differences in accounting principles among foreign nations must be rationalized;<sup>36</sup> foreign currencies must be converted; foreign property values must be restated; and elaborate reports must be created in conformity with the requirements of the Board.

The cost of doing this is overwhelming. The estimated annual cost of £ two million for Imperial to establish and maintain the accounting system required is greater than the total amount of franchise tax that the Board has, so far, assessed over a ten year period on the Imperial Group's foreign source income taxed to Americas.<sup>37</sup>

The Board observed that Imperial is complaining about the expense of the compliance effort and that this expense diminishes the value of Imperial's investment in Americas.<sup>38</sup> The latter point may be true but is not part of Imperial's complaint. What the compliance cost really diminishes is the cash in Imperial's own accounts. To make matters worse, this expense cannot be deducted by anyone for U.S. federal income tax purposes. Imperial is not subject to United States income taxes,<sup>39</sup> and if the expense were reimbursed by Americas to Imperial, the payment by Americas would not be deductible for federal income tax purposes because it relates to income not subject to federal tax.<sup>40</sup> Even if directly incurred by Americas, the expense would be nondeductible for the same reason. Any nondeductible payment by Americas to Imperial to reimburse such costs would be a non-

<sup>35</sup> JA 115-118.

<sup>36</sup> The Price Waterhouse Survey (Ex. 15) identifies several dozen fundamental accounting policies as to which the practices or requirements in sixty-four countries vary widely.

<sup>37</sup> JA 48; JA 117.

<sup>38</sup> Pet. Br. p. 39.

<sup>39</sup> INT. REV. CODE §§ 882(a) & 884(e)(1).

<sup>40</sup> INT. REV. CODE § 265. The Treasury (IRS) long ago determined that legal fees incurred by an alien in contesting a foreign tax are not deductible to the extent allocable to foreign tax on income exempt from (U.S.) federal tax. Rev. Rul. 62-9, 1962-1 CB 35. U.S. Treasury regulations require State unitary tax assessments on foreign source income to be allocated to that income in the same manner as *foreign* taxes on such income. Reg. § 1.861-8T, Example (25).

deductible deemed distribution for federal and State tax purposes subject to the usual rules on distributions, which include federal dividend withholding taxes.

The point is that the irreconcilable conflict of California's practice with that of the federal government and the international community puts foreign investors such as Imperial in an untenable position with respect to compliance. After setting elaborate and detailed requirements for production of extensive data to compute the tax, observance of which would give rise to the large compliance costs estimated in this case, the Board's regulations offer this alternative: "In appropriate cases, such as when the necessary financial data cannot be developed from financial records maintained in the regular course of business, the Franchise Tax Board may accept reasonable approximations."<sup>41</sup> The result is that if accounting data to support the taxpayer's position is not available, or if the cost to produce it is likely to exceed the tax, California tax must be determined by negotiation with the Board. In negotiations, the Board will always have the upper hand because of the burden of proof. This is, apparently, exactly what the Board intended.

There is no way of meeting the burden of proof without incurring the compliance costs. It clearly would be too expensive for Imperial to undertake compliance without any assurance it would reduce its taxes. The Board acknowledge their negotiating advantage in the present case by asserting<sup>42</sup> that "any additional information furnished by the parent companies" would not substantially alter the amount of taxes on the Imperial Group's income.

(c) *Interference with Decision Making.* As parent company of a multinational group comprising hundreds of subsidiaries in more than 50 nations, Imperial has major planning and fiscal responsibilities. While Imperial's investment and strategic decisions affect all members of the Imperial Group, many of those subsidiaries are largely autonomous with regard to their own investment and operating decisions. A

<sup>41</sup> Reg. 25137-6(e)(1). See *infra* Appendix At 1-8.

<sup>42</sup> Pet. Br. p. 39, n. 13.

principal complaint Imperial has about the Board's tax regime is that so long as the California numerators of the three factor apportionment fraction remain constant, any change in the worldwide denominators increases or decreases taxable income apportioned to California. If a subsidiary with property, payroll, and sales in India is sold by Imperial, each of the three apportionment fractions increases and the California tax assessment increases. Similarly, if the managers of an autonomous subsidiary in India decide to sell its plant, the sale will increase California taxes.

The California method of assessment draws no distinction between a parent company and a subsidiary. While the court of appeals did not share Imperial's view of the "upstream" effect (i.e. the Board's treatment of the subsidiary as though it controlled its parent), the economic reality is that subsidiaries in one country do not make or even participate in decisions affecting investment and operations in another country. The court of appeals focused on the opposite effect, i.e., the "downstream" aspect of unitary taxation that treats the subsidiary as a branch of the parent. The point made by the court of appeals was that California's tax regime forces the foreign parent to avoid subsidiary operations in California and operate, instead, through arm's length contracts in order to protect its foreign source income from California tax.

It is this constraint that clearly contravenes federal policy. It is absolutely correct that by choosing to deal through arm's length contracts with independent distributors and commission agents when making sales into California, Imperial can insulate its foreign source income from California tax assessments. The Board not only misstate<sup>43</sup> what the court of appeals said, but totally confuse the issue by arguing<sup>44</sup> any taxable income Imperial receives from California would have to be determined under the unitary method. The point the court of appeals was making is that if Imperial only *sells* into California through arm's length contracts, Imperial doesn't have California source income. By not having Califor-

<sup>43</sup> Pet. Br. p. 27.

<sup>44</sup> Pet. Br. p. 28.

nia source income, Imperial would not be subjected to worldwide unitary tax assessment.

Comparison of the court of appeals opinion<sup>45</sup> with the Board's argument<sup>46</sup> reveals the extent to which the Board have tried to obfuscate what the court of appeals intended. The pivotal issue is simply this: Does the Board have the right to force a foreign parent to avoid subsidiary operations in California in order to protect its foreign source income from California assessment? If California were a sovereign nation, the answer would clearly be "yes." But as a member of a federal republic that specifically gives the prerogative of foreign economic policy to the federal government, California has surrendered that right. The federal government's choice in foreign commerce, not California's, should prevail in this case.

2. *Imperial's Injuries are Independent of Those to its Subsidiary, Americas.* Based on the opinion of the court of appeals, the Board assert that Imperial's allegations of double taxation and excessive compliance costs do not constitute injuries that are independent of those to Americas. The Board, furthermore, attack the court of appeals finding that the burden on Imperial's decision-making is sufficiently direct and independent to confer standing. The Board's assertions are in error.

It is irrefutable that actual double taxation exists or will exist in this case because of the "serious divergence in the taxing schemes adopted by California and the foreign taxing authorities."<sup>47</sup> The court of appeals below, suggested that "it is possible to view these taxes . . . simply as added costs for the domestic subsidiary . . ."<sup>48</sup> This view may be possible but Imperial bears directly the incidence of this tax when the United Kingdom tax credit is denied on dividend distributions from excessively taxed income of Americas. The burden of double taxation is an injury suffered by Imperial directly, not indirectly through Americas.

<sup>45</sup> 860 F.2d, n. 10 at 697.

<sup>46</sup> Pet. Br. n. 9, at 27-28.

<sup>47</sup> *Container Corp.*, 463 U.S. at 187.

<sup>48</sup> 860 F.2d at 696.

It is irrefutable that the Board's worldwide combined income reporting requirements imposed on Imperial are both extensive and expensive. The court of appeals, however, noted that the cost of compliance like double taxation, "can be viewed, in principle, as an increase in the overhead of the California operations."<sup>49</sup> While this view may also be possible, the burden of complying with the Board's information requests nevertheless falls directly on Imperial, not Americas. Only Imperial has access to Imperial Group information regarding worldwide revenue and cost data, worldwide payroll accounts, worldwide cash movement, and worldwide property accounts.

In addition to the double tax and compliance burdens, the incidence of California's unitary tax impermissibly impairs Imperial's ability to plan and conduct foreign commerce without interference from California. The court of appeals correctly found that the unitary tax burdens Imperial's foreign commerce by discriminating against the use of subsidiaries in commerce which could be conducted without worldwide tax exposure through arm's length arrangements. The Board distort the court of appeals analysis by ignoring the fact that no California taxes are imposed on Imperial's worldwide income as a result of commerce with non-affiliates and that it is the possibility of shifting "a higher proportion of the corporate tax burden onto companies that are affiliated with foreign operations"<sup>50</sup> which is the constitutionally significant offense. The Board's attack on the court of appeals finding that Imperial "could conduct precisely the same foreign commerce" through unaffiliated companies as it does through Americas ignores commercial reality. No reason exists why Imperial could not contract with an independent company to conduct research, manufacture to Imperial's specifications, or conduct any other commercial activity in California for that matter without subjecting Imperial's foreign source income to California tax.

<sup>49</sup> *Ibid.*

<sup>50</sup> 860 F.2d at 697, n.10.

The Board finally argue<sup>51</sup> that this Court has already rejected Imperial's "classic" argument against formula apportionment, most recently in *Shell Oil Company v Iowa Dept. of Rev.*<sup>52</sup> That statement simply ignores the facts in *Shell Oil*. The taxpayer was a Delaware corporation being assessed proportionally on its own "unitary" income within and without the State of Iowa but *entirely within* the jurisdiction of the United States. No one now seriously questions the use of unitary apportionment by the States to tax U.S. source income. *Container Corp.* makes it clear that the foreign source income of a U.S. parent and its subsidiaries also may be so apportioned and taxed. The taxpayer's argument in *Shell* was that Congress had exempted by statute income from the sale of Outer Continental Shelf oil and gas. This Court concluded that there was no intent by Congress to grant such an exemption. This principle has nothing to do with the instant case. The Board's argument in this respect serves to highlight what is the central feature of their tax regime: That unitary apportionment may be applied by them to any multinational group, irrespective of nationality, irrespective of federal economic policy, irrespective of the difficulty it creates for foreign based businesses irrespective of foreign retaliation against U.S. businesses, and wholly irrespective of the impact on foreign relations of the United States.

## II. CALIFORNIA DOES NOT PROVIDE A FORUM TO HEAR CLAIMS OF INJURY ARISING FROM INTERACTION OF FEDERAL LAW WITH FOREIGN LAW.

The sole remedy in California State courts is a claim for refund of taxes paid. No declaratory or injunction relief respecting classes of income or persons assessed is permitted. Imperial, itself, as the Board concede is denied access to California courts. What the Board argue is that Imperial's claims of double taxation, compliance costs, and interference with decision making should be litigated on Imperial's behalf

<sup>51</sup> Pet. Br. p. 37.

<sup>52</sup> —U.S.—, 109 S. Ct. 278, 102 L. Ed. 2d 186 (1988).

by its subsidiary, Americas. Since Imperial's claims cannot be litigated in California courts, the Board are actually seeking to have Imperial's claims declared non-justiciable.

### A. AS THE COURT OF APPEALS HELD, IMPERIAL HAS NO REMEDY IN CALIFORNIA COURTS.

The court of appeals held that California did not provide an adequate remedy under the circumstances of this case. Imperial urges that the record as well as the admission in the Board's brief<sup>53</sup> that "California affords remedies only to the taxpaying entities," support that holding.

Whether Imperial's claims are substantial enough to sustain a claim of independent injury is something that should be decided by the trial court after weighing all of the evidence. If Imperial is denied standing, the trial court will never consider the evidence of direct injury. All the court of appeals decision gives Imperial is a chance to prove the nature and extent of allegedly independent injuries.

The Board captiously argue that even though Imperial has no standing in a California court it follows that Imperial is not thereby deprived of effective State remedies.<sup>54</sup> Imperial submits, to the contrary, that it *is* deprived of a remedy. Under California law, the exclusive remedy to contest the tax in California court is a taxpayer's action for refund of taxes paid.<sup>55</sup> California law prohibits injunctive relief in a California court to enjoin the assessment or collection of a tax.<sup>56</sup>

The only California worldwide unitary tax case that involves a foreign parent is a refund action that does not address standing.<sup>57</sup> In that case, the plaintiffs were a California corporation and its United Kingdom parent. Both corporations were California taxpayers and both had standing in California to sue for refunds of taxes collected. The California trial court held the worldwide unitary tax to be unconstitu-

<sup>53</sup> Pet. Br. p. 43.

<sup>54</sup> *Ibid.*

<sup>55</sup> CAL. REV. & TAX. Code § 26102.

<sup>56</sup> CAL. REV. & TAX. Code § 26101.

<sup>57</sup> *Barclay's Bank Int. Ltd. v Franchise Tax Bd.*, No. 32059, Cal. Super. Ct. (Sacramento Co., 1987), appeal pending.

tional on foreign commerce and other grounds similar to those urged by Imperial in the instant case.

**B. AMERICAS DOES NOT HAVE STANDING IN A CALIFORNIA COURT TO LITIGATE THE INJURIES ALLEGED BY IMPERIAL.**

Americas, unlike Imperial, is not within the class of foreign investors protected by federal foreign commerce policy. None of the three issues alleged as injuries by Imperial can be fully dealt with in a California refund suit by Americas against the federal policy background.

1. *The Economic Double Taxation Issue.* Under the Board's unitary tax method, Americas will pay no foreign taxes but will pay a California tax measured by foreign source income earned by foreign corporations. As shown previously, Americas may claim that its tax is measured by excessive income, but may not claim *double* tax because the double tax arises when a U.K. tax becomes due without a credit. To make a claim of impermissible double taxation, therefore, Americas has to base its claim on Imperial's income and Imperial's foreign taxes, and it must do so in a refund suit that does not include Imperial.

2. *The Excessive Costs of Compliance Issue.* The extraordinary costs of compliance must be borne initially by Imperial, because the required information must be derived from the accounting records of Imperial and its subsidiaries outside the United States. The costs and burdens, consequently, would not in the first instance be costs and burdens imposed on Americas and Americas would again be forced to assert someone else's burden in an Americas' California refund action. Although payment of these costs might as a business matter be shifted to Americas by Imperial, an unconstitutional burden on foreign commerce cannot be so readily shifted.

If such shifting or sharing were treated, moreover, as simply converting Imperial's cost into an intercorporate distribution by a subsidiary to its parent corporation, the result would be, as explained previously, that the cost could never

then be charged against income for tax purposes by any entity in any jurisdiction.

3. *The Interference With Decision Making Issue.* There is no way in which Imperial's decision-making power can be said to be shared with Americas. As a subsidiary corporation, Americas has no voice or participation whatever in the decisions made by Imperial. This is true of Imperial's decision to incorporate or purchase Americas, Imperial's continuing decision in owning Americas and any future decision to dissolve or sell Americas. Even more to the point, the same conclusion applies to Imperial's decision as to its capital investments in foreign countries other than the United States, which as explained above, are decisions directly impacted by California's unitary tax. They are not, however, decisions which Imperial shares with Americas.

If the California courts would recognize corporations as taxpayers on the basis of assessments rather than collections, Imperial itself would have standing in California courts and the Tax Injunction Act or comity would apply to bar standing in federal court. Such is not the case and the court of appeals, below, correctly held that "comity and federalism, weighty as these concerns are where federal courts pass on the constitutionality of State tax legislation, cannot justify withholding federal jurisdiction from a party with no cause of action in State court to redress its own direct and independent injury."<sup>38</sup>

The Board make several arguments to refute this point, none of which withstands analysis. The Board argue that "any constitutional objection that the parent companies have are shared with the taxpayer subsidiaries."<sup>39</sup> This sweeping generalization does not fit the facts of this case.

The Board's position in this case rests on the uncontroverted proposition that a shareholder has no standing to litigate claims based on injury to the corporation (Imperial, of course, is pressing its own claim of injury, not Americas'). Since this is so, it follows with equal or greater force that a

<sup>38</sup> 860 F.2d at 699.

<sup>39</sup> Pet. Br. p. 48.

corporation has no standing to raise claims based on injury to its shareholders. The Board will inevitably take that position in any California refund action by Americas and their present assertion (or even concession) to the contrary in this case would not be binding on a California court in a refund action by a party (Americas) not before this Court.

The Board argue that their conclusion that the constitutional objections of Imperial are shared with Americas follows from *Exxon Corp. v Governor of Md.*,<sup>60</sup> stating that, "... the Clause protects the interstate market, not particular interstate firms, from prohibited or burdensome regulations."<sup>61</sup>

*Exxon Corp.* did not involve standing at all, nor was the quoted statement directed toward standing. It was instead an affirmation that the Commerce Clause protects commerce as a whole, not some particular market structure and was a refutation of the argument that a State statute violated the Commerce Clause because it would change the market structure by weakening the independent refiners who were plaintiffs. While the quoted statement is true the Board's argument is a non sequitur. The statement does not address whether a foreigner's burdens are shared with a domestic company. The statement addresses the substantive issue of State taxing power, not the standing issue. It is plain that the Commerce Clause cannot be invoked in the abstract; it can only be invoked by a litigant having the individual rights protected by the Commerce Clause, and then only if the litigant has suffered an injury.

*Exxon Corp.* and the authorities cited therein simply support the uncontroverted proposition that the Commerce Clause implicates national and State interests in an adjudication of the merits of a claim, and do not address the standing of a party to raise the claim.

<sup>60</sup> 437 U.S. 117 (1978).

<sup>61</sup> *Id.* at pp. 127-128.

### C. THE DECISION OF THE COURT OF APPEALS DOES NOT GRANT LICENCE TO SHAREHOLDERS TO RESTRAIN STATE TAX ASSESSMENTS IN FEDERAL COURT.

A number of States who have stated that they have no interest in the constitutionality of California's worldwide unitary tax, joined in a brief as *amici curiae*, asking that standing be denied in this case. The fear expressed by this brief, and by that of the Council of State Governments, the National League of Cities and others, is legitimate but unfounded. Imperial agrees with the statement in the *amicus* brief that "the appropriate party to litigate the validity of their taxes is the taxpayer and that the appropriate forums are their State courts."<sup>62</sup> Under the Board's interpretation of California law, Imperial *is* the taxpayer for assessment but is *not* the taxpayer for payment or refund suit.<sup>63</sup> The Board, in fact, admit this but apparently do not regard it as inconsistent or burdensome.<sup>64</sup>

Where the States' Brief errs is in the statement that the court of appeals opinion, below, "provides a blueprint for avoiding the will of Congress in this area as expressed in the Tax Injunction Act (28 U.S.C. § 1341)."

The decision of the court of appeals in this case cannot be separated from the facts and the relief sought upon which it is based. This action does not seek to restrain either collection or enforcement of California taxes against Americas. What is sought is a declaration that California, in assessing those taxes, may not include Imperial, a nonresident alien with no U.S. source income, as a "taxpayer" together with Americas. The only reason for this lawsuit is that, after having included Imperial as a "taxpayer," Imperial isn't

<sup>62</sup> Brief of the State of Idaho ("States' Brief") as *amicus curiae*, p. 2.

<sup>63</sup> CAL. REV. & TAX. CODE. §§ 25129, 25130, 25131, and 25134. This "multifaceted" use of the term by California was noted in *Appeal of Finnigan Corp.*, 88-SBE-022 (1988) by the California State Board of Equalization. See discussion on p. 4-4, Imperial's Brief in Opposition, Appendix 4 (reprint of the opinion in full).

<sup>64</sup> Pet. Br., p. 40, n. 14: "... [T]he term taxpayer in the second clause refers to all components of the unitary business but the same term in the first clause refers only to the entity doing business in California." Cf. FTB Reg. § 25137-6(a)(1), *infra*, Appendix at 1-1.

allowed to protest that assessment in California on the only grounds that matter—the federal Constitution and federal foreign economic policy. It is impossible to conceive of another set of facts or a taxing regime other than the Board's application of California's unitary method that would, in combination, permit an action of this nature in federal court.

There is no dispute as to the principles of law respecting standing to be applied. These were stated in *Simon v Eastern Kentucky Welfare Rights Org.*<sup>65</sup> to be: Whether the injury is likely to be redressed by a favorable decision; whether the plaintiff has a concrete injury as contrasted with an abstract concern; and whether the injury can fairly be traced to the defendant as distinguished from some third party.

The enquiry, thus, is factual and Imperial urges that it has satisfied all three principles upon the present record. The issue of highest concern in the States' Brief is not standing but federal court jurisdiction to interfere in State assessment and collection procedures. The case most relevant to that issue is *Fair Assessment in Real Estate v McNary*.<sup>66</sup> This Court held that the Tax Injunction Act as well as principles of comity barred a taxpayer's damage action in federal court that alleged unconstitutional administration of a State tax system based on unequal assessments on property. But this holding rested on the express finding that "the adequacy of available . . . [State] remedies is not at issue in this case."<sup>67</sup> The question here is, therefore, does California provide Imperial with an adequate remedy? As demonstrated above, the answer is plainly "no."

If there is truly concern that shareholders generally will use the court of appeals decision as authority to enjoin State assessment and collection proceedings, this Court should rule, explicitly, that such is not the case. The reasons are:

(a) The object of this action is only to restrain California from including Imperial's income from sources without the United States in California's appor-

<sup>65</sup> 426 U.S. 26, 38-44 (1976)

<sup>66</sup> 454 U.S. 100 (1981).

<sup>67</sup> 454 U.S. at 116.

tionment base. California is the only State to make such an apportionment. There is no interference with California's audit and collection process vis-a-vis the income of the U.S. subsidiary, Americas, as determined under federal law and international practice. This is not a device to avoid State court, it is the only recourse since Imperial is barred from State court.

(b) The court of appeals decision requires *all three* of the following to be present before a *foreign* parent can have standing to claim injury by State action:

(i) There must be an area of recognized federal supremacy involved, such as war, issuance of money, foreign relations, or foreign commerce into which the State action intrudes.

(ii) The federal government must not have given its permission to the State to make the intrusion, either expressly or by implication. In *Container Corp.*,<sup>68</sup> this Court found that applying worldwide income apportionment to a *domestic* parent didn't have enough impact on U.S. foreign relations and commerce to constitute such an intrusion.

(iii) There must not be a method by which the claims of injury to the foreign parent can be adequately presented in the State's courts.

The court of appeals correctly held that unless *all three* of these elements are present in a tax case, the federal courts should not hear the case. It also correctly held, and Imperial urges this Court to affirm, that all three elements are present in this case and that Imperial therefore has standing. Imperial urges this Court to affirm that holding and to grant Imperial the opportunity to prove its case.

<sup>68</sup> See *infra* p.7, n. 4.

CONCLUSION

For the reasons stated, the decision of the Seventh Circuit Court of Appeals, below, should be affirmed and the case remanded to the District Court for the Northern District of Illinois for further proceedings.

Respectfully submitted,

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11 July 1989

## APPENDIX

CALIFORNIA FRANCHISE TAX BOARD REGULATION SECTION  
25137-6 Combined Reports Including Foreign Country Operations; 18 Cal. Admin. Code § 25137-6

## (a) In General.

(1) Unitary Business. A taxpayer is engaged in a unitary business (or a single business within the meaning of Reg. 25120(b) when its activities within the state contribute to or are dependent upon its activities without the state. A unitary business exists when there is unity of ownership, unity of operation and unity of use.

(2) Translation Method for Determining Income. The translation method to be used for determining income shall be the "profit and loss method" as set forth in this regulation. This method excludes unrealized exchange rate gain or loss resulting from the restatement of assets or liabilities, while taking into account exchange gains or losses attributable to income transactions.

(3) General Applicability of UDITPA Regulations. The general regulations for UDITPA, Regs. 25120-25139, inclusive, shall be applicable except as otherwise provided in this regulation.

## (b) Determination of Income.

(1) The income of a unitary business with operations in foreign countries shall be computed in the following manner:

(A) A profit and loss statement shall be prepared for each foreign branch or corporation in the currency in which the books of account of the branch or corporation are regularly maintained.

(B) Adjustments shall be made to the profit and loss statement to conform it to the accounting principles generally accepted in the United States for the preparation of such statements except as modified by this regulation.

(C) Adjustments shall be made to the profit and loss statement to conform it to the tax accounting standards required under Division 2 Part 11 of the Revenue and Taxation Code.

(D) The profit and loss statement of each branch or corporation, whether U.S. or foreign, shall be translated into the currency in which the parent company maintains its books and records in accordance within subsection (b)(4).

(E) Business and nonbusiness income as determined under California law shall be identified and segregated. For general definition, rules and examples for determining business and nonbusiness income, see Regulation 25120.

(F) Nonbusiness income shall be allocated to a specific state pursuant to the provisions of Sections 25124 to 25127, inclusive of Division 2 Part 11 of the Revenue and Taxation Code.

(G) Business income shall be included in the combined report prepared for the unitary business and shall be apportioned on the basis of the appropriate formula for the business.

(H) Income from California sources shall be expressed in dollars in accordance with subsection (b)(4) and the taxes computed accordingly.

(2) In lieu of the procedures set forth in subsection (b)(1) and subject to the determination of the Franchise Tax Board that it reasonably reflects income, a unitary business with operations in a foreign country may determine its income on the basis of the consolidated profit and loss statement prepared for the related corporations of which the unitary business is a member which is prepared for filing with the Securities and Exchange Commission. If the business is not required to file with the Securities and Exchange Commission, the consolidated profit and loss statement prepared for reporting to shareholders and subject to review by an independent auditor may be used.

(A) Adjustments shall be made, if necessary to:

(i) conform to the accounting principles generally accepted in the United States for the preparation of such statements, except as modified by this regulation;

(ii) conform to the tax accounting standards as required under Division 2 Part 11 of the California Revenue and Taxation Code; and

(iii) eliminate unrealized gain and losses resulting from the restatement or revaluation of assets or liabilities to reflect changes or fluctuations in currency values.

(B) Business and nonbusiness income as determined under California law shall be identified and segregated. For definitions, rules and examples for determining business and nonbusiness income, see generally Regulation 25120.

(C) Nonbusiness income shall be allocated to specific states pursuant to the provisions of Sections 25124 to 25127, inclusive of the Revenue and Taxation Code.

(D) Business income shall be included in the combined report prepared for each unitary business and will be apportioned on the basis of the appropriate formula for each business.

(E) Income from California sources shall be expressed in dollars in accordance with subsection (b)(4) and the taxes computed accordingly.

(3) For purposes of subsections (b)(1)(B), (b)(1)(C), and (b)(2)(A), the following rules shall apply:

(A) Accounting adjustments to be made to conform profit and loss statements to those utilized in the United States—

(i) Include but are not limited to the following:

(I) Clear reflection of income. Any accounting practice designed for purposes other

than the clear reflection on a current basis of income and expense for the taxable year shall not be given effect. For example, an adjustment shall be required where an allocation is made to an arbitrary reserve out of current income.

(II) Physical assets, depreciation, etc. All physical assets, including inventory when reflected at cost, shall be taken into account at historical cost computed either for individual assets or groups of similar assets. The historical cost of such an asset shall not reflect any appreciation or depreciation in its value or in the relative value of the currency in which its cost was incurred. Depreciation, depletion, and amortization allowances shall be based on the historical cost of the underlying asset, and no effect shall be given to any such allowances determined on the basis of a factor other than historical cost.

(III) Valuation of assets and liabilities. Any accounting practice which results in the systematic undervaluation of assets or overvaluation of liabilities shall not be given effect, even though expressly permitted or required under foreign law, except to the extent allowable under subsection (b)(3)(B). For example, an adjustment shall be required where inventory is written down below market value.

(IV) Income equalization. Income and expense shall be taken into account without regard to equalization over more than one accounting period; and any equalization reserve or similar provision affecting income or expense shall not be given effect, even though expressly permitted or required under foreign law.

(ii) Currency gains or losses on closed transaction are includible, but no adjustments shall be made, or otherwise reflected, for unrealized gains or

losses resulting from the restatement or revaluation of assets or liabilities to reflect changes or fluctuations in currency values. A closed transaction is one where any foreign exchange position taken by a corporation has been terminated by exchanging the foreign currency for the currency in which the individual corporation maintains its books and records and normally conducts its business affairs. In the case of borrowing in a foreign currency, the transaction shall not be deemed closed until repayment is made.

(B) The tax accounting adjustments to be made shall include, but are not limited to, the following:

(i) Accounting methods. The method of accounting shall reflect the provisions of Section 24651 of the Revenue and Taxation Code and the regulations thereunder.

(ii) Inventories. Inventories shall be taken into account in accordance with the provisions of Sections 24701 through 24706 of the Revenue and Taxation Code and the regulations thereunder, except Regulation 24702-24706(b)(5).

(iii) Depreciation, depletion, and amortization. Depreciation, depletion, and amortization are to be computed in accordance with California law.

(iv) Elections.

(I) Elections required to be made for purposes of determining income under Division 2 Part 11 of the Revenue and Taxation Code of all California reporting entities shall be made in accordance with applicable provisions of such law and the regulations adopted pursuant thereto.

(II) Elections required to be made for purposes of determining income under Division 2 Part 11 of the Revenue and Taxation Code for

entities which are not subject to taxation by California but are required to be included in the combined report for the unitary business shall be made by agreement of all entities required to report to California in accordance with the applicable provisions of such law and the regulations adopted pursuant thereto. If agreement cannot be reached, such income shall be reported on the basis of United States generally accepted accounting principles.

(C) No adjustment shall be required under subsections (b)(3)(A) and (b)(3)(B) unless it is material. Whether an adjustment is material depends upon the facts and circumstances of the particular case, including the amount of the adjustment, its size relative to the general level of the corporation's total assets and annual profit or loss, the consistency with which the practice has been applied, and whether the item to which the adjustment relates is of a recurring or a nonrecurring nature.

(4) For purposes of determining income, necessary translations shall be made at the following exchange rates:

(A) Depreciation, depletion, or amortization shall be translated at the appropriate exchange rate for the translation period in which the historical cost of the underlying asset was incurred.

(B) All other items shall be translated at either the end-of-year exchange rate or at the simple average exchange rate for the translation period. Income repatriated during the year shall be translated at the exchange rate at date of repatriation. It is presumed that the translation rate used in preparing the consolidated profit and loss statement for financial reporting purposes is proper absent a showing that some other method is appropriate.

A change from end-of-year rates or average rates may not be made without the permission of and on such conditions as the Franchise Tax Board may prescribe.

(c) Computation of Factors. In computing the formula factors, the following rules shall apply:

(1) Property Factor.

(A) Fixed assets shall be valued at original cost as defined in Reg. 25130(a) and translated at the exchange rate as of the date of acquisition.

(B) Rented property, capitalized at eight times its annual rental rate, shall be translated at the simple average of the beginning and end-of-year exchange rate.

(C) Inventories shall be valued at original cost and shall be translated at the exchange rate as of the date of acquisition.

(D) For purposes of calculating the property factor of financial corporations, financial assets are translated at the year-end rate and are defined as assets reflecting a fixed amount of currency, such as cash on hand, bank deposits, and loans and accounts receivable. Securities held, or reasonably expected to be held, for less than six months shall be translated at year-end rates. If a security is held, or reasonably expected to be held, for more than six months, it shall be translated at the appropriate exchange rate for the translation period in which the historical cost of the asset is determined.

(E) The property factor shall be computed in the currency of the parent company unless the taxpayer requests and the Franchise Tax Board determines that computing the factor in dollars or any other currency fairly reflects the taxpayer's activities in California.

(2) Payroll and Receipts Factors.

(A) Translations shall be made at the simple average of the beginning of end-of-year exchange rates unless there is a substantial fluctuation, as described in subsection (d)(2).

(B) Where the value of the foreign currency does fluctuate substantially, as described in subsection (d)(2)

the exchange rate appropriate to that period shall be either (1) a simple average of the month-end rates, or (2) a weighted average taking into account the volume of transactions (reflected by the amount being translated) for the calendar months ending with or within that period.

(C) In computing the payroll and receipts factors, translation shall be made into the parent company's currency in order to properly determine the percentage factor to be used unless the taxpayer requests and the Franchise Tax Board determines that computing the factors in dollars or any other currency fairly reflects the taxpayer's activities in California.

(d) Exchange Rates.

(1) For purposes of preparing combined reports, exchange rates may be derived from any source which is demonstrated to the satisfaction of the Franchise Tax Board to reflect actual transactions conducted in a free market and involving representative amounts. In the absence of such demonstration, the exchange rates taken into account in computation of the earnings and profits of the foreign corporation shall be determined by reference to the free market rate set forth in the pertinent monthly issues of *International Financial Statistics* or successor publications of the International Monetary Fund.

(2) In general, the extent of fluctuation is substantial if the closing rate for any calendar month ending within the period varies by more than 10 percent from the closing rate for any preceding calendar month ending within the period.

(e) Application of Regulation.

(1) In computing the income and any of the factors required for a combined report, the Franchise Tax Board shall consider the effort and expense required to obtain the necessary information. In appropriate cases, such as when the necessary data cannot be developed from financial records

maintained in the regular course of business, the Franchise Tax Board may accept reasonable approximations.

(2) A taxpayer may request an advance determination under subsections (b)(2), (b)(3)(C), (c)(1), (d)(1) or any other provision of this regulation by submitting a determination to the Legal Division of the Franchise Tax Board. Such a determination shall be made on an individual basis and shall be limited to the particular facts or circumstances set forth in the determination request. The facts and circumstances upon which a determination is made remain subject to review. Failure to request or to obtain a favorable advance determination will not be preclude consideration of requested variances in subsequent proceedings.

AUG 9 1989

JOSEPH F. SPANIOL, JR.  
CLERK

**In the Supreme Court**  
of the  
**United States**

OCTOBER TERM, 1989

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA;  
LEONARD WILSON, Individually and as District Manager, Chi-  
cago Office of the Franchise Tax Board of the State of California;  
and B.M. RARANG, Individually and as Auditor, Chicago Office  
of the Franchise Tax Board of the State of California,  
*Petitioners,*

VS.

ALCAN ALUMINIUM LIMITED and IMPERIAL CHEMICAL  
INDUSTRIES PLC,  
*Respondents.*

**On Writ of Certiorari to the  
United States Court of Appeals  
for the Seventh Circuit**

**REPLY BRIEF OF PETITIONERS**

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No. 88-1400

**In the Supreme Court**  
of the  
**United States**

OCTOBER TERM, 1989

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA;  
LEONARD WILSON, Individually and as District Manager, Chicago Office of the Franchise Tax Board of the State of California;  
and B.M. RARANG, Individually and as Auditor, Chicago Office of the Franchise Tax Board of the State of California,  
*Petitioners,*

VS.

ALCAN ALUMINIUM LIMITED and IMPERIAL CHEMICAL  
INDUSTRIES PLC,  
*Respondents.*

On Writ of Certiorari to the  
United States Court of Appeals  
for the Seventh Circuit

## REPLY BRIEF OF PETITIONERS

INTRODUCTION AND  
SUMMARY OF ARGUMENT

Respondents in this matter, both of which are corporations organized and doing business outside the United States, are attempting to litigate an issue left open in *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983): whether it is constitutionally permissible for a state to use the unitary business/formula apportionment method of accounting to calculate the taxable income of U.S. subsidiaries of foreign parent companies. Although the parent companies are not the taxpayers di-

rectly concerned, they claim that they have standing in the federal courts to litigate this constitutional issue and should not be impeded by either the Tax Injunction Act or its underlying principle of comity. The Franchise Tax Board of the State of California contends that the taxpayer-subsidaries are the only proper parties to challenge the constitutionality of the method by which they have been taxed. The Board further contends that, even if it is assumed or determined that the parent companies also have standing to make such a challenge, they should not be permitted to resort to the federal courts due to the total control they exercise over their subsidiaries' pursuit of alternative state remedies.

The parent companies' claim of standing essentially rests on two arguments: (1) that *only* the parent companies are in a position to object to California's method of taxation on Foreign Commerce Clause grounds, and (2) that, in any case, California's method of taxation imposes burdens on the parent companies that are different from those imposed on the corporate taxpayers. The first argument is inconsistent with the parent companies' basic premise that the Foreign Commerce Clause is applicable here because their U.S. subsidiaries constitute "instrumentalities of foreign commerce." If that premise is correct, the subsidiaries, as the "instrumentalities of foreign commerce" which are required to pay the assertedly illegal taxes, clearly have standing to object to California's method of taxation on Foreign Commerce Clause grounds. The second argument is faulty because it assumes, without further analysis, that a corporate stockholder is entitled to bring an individual action whenever the alleged injuries to the stockholder differ from those suffered by the corporation. This is an oversimplified interpretation of the stockholder standing rule. A corporate stockholder who is injured by actions taken against the corporation may complain of such actions only when he has distinct legal rights or interests at stake. That factor—the holding of distinct legal rights or interests—is the necessary ingredient missing in the present case.

Furthermore, even if the parent companies hold distinct legal rights and thus are directly affected by the taxes imposed on their subsidiaries, they should be required to pursue the state remedies

effectively available to them. The parent companies have total control over their U.S. subsidiaries, and hence total control over the pursuit of state remedies by the actual taxpayers. The argument that such remedies are inadequate because there is no assurance that a state court would address all of the Foreign Commerce Clause issues is ill-founded. This Court held in *Container* that, when a state tax case involves a unitary business that is international in scope, as distinguished from a unitary business that operates only in interstate commerce, the case must be subjected to the additional scrutiny required by the Foreign Commerce Clause. 463 U.S., at 185. It cannot be presumed that a state court will decline to follow this mandate.

## ARGUMENT

### I

#### THE TAXES IN QUESTION ARE BEING ASSESSED AGAINST THE DOMESTIC SUBSIDIARIES UNDER A METHOD OF ACCOUNTING WHOSE BASIC FAIRNESS IS BEYOND DISPUTE

##### A. The actual taxpayers are the domestic subsidiaries, not their parent companies or the unitary businesses in which they participate

In both of the actions before the Court, it is a *stipulated fact* that the taxes in question have been assessed only against the respondents' domestic subsidiaries. JA 53, 99. This undisputed fact obviously raises a formidable obstacle to respondents' claims that they have standing to litigate the constitutionality of the tax assessments and must be afforded a direct remedy for doing so. Undaunted, respondents insist that the obstacle in their path is only a mirage. Both argue throughout their briefs that the stipulated identity of the taxpayers is meaningless, and that the "actual" taxpayers are either (1) the parent companies themselves, or (2) the unitary enterprises as a whole, for which the respective parent companies are the proper spokesmen.<sup>1</sup>

<sup>1</sup> Alcan goes so far as to assert that the "real party in interest" is the parent company, and therefore whether its subsidiary could challenge

The use of the unitary business/formula apportionment method of accounting as applied to a domestic company with foreign subsidiaries was upheld by this Court in *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983). During the course of its opinion, the Court observed that "Although California 'counts' income arguably attributable to foreign corporations in calculating the taxable income of that domestic corporation, the legal incidence of the tax falls on the domestic corporation." 463 U.S., at 195. That, of course, is true here as well. The legal incidence of the tax falls on the domestic corporations which are the entities doing business in California and are the entities against which the taxes have been assessed. Thus no amount of hocus-pocus can disguise the fact that it is the domestic subsidiaries which are the California taxpayers.<sup>2</sup>

Respondents and their amici nevertheless try their hand at magically transforming the domestic subsidiaries into nontaxpayers or, at best, only "nominal" taxpayers. Imperial, for example, asserts that California law classifies the entire unitary enterprise as the "taxpayer" for assessment purposes.<sup>3</sup> Imperial is

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the tax assessments in the state courts "is in serious doubt." Brief for Respondent Alcan Aluminium Limited ("Alcan Brf."), at 47, n. 24. The assertion is patently absurd.

<sup>2</sup> The Court said in *Container* that, in analyzing the constitutional claims based on the Foreign Commerce Clause, "the fact that the legal incidence of a tax falls on a corporation whose formal corporate domicile is domestic might be less significant in the case of a domestic corporation that was owned by foreign interests." 463 U.S., at 195, n. 32. In other words, the foreign parentage of a domestic corporation may bear on the merits of the constitutional claims. However, it has nothing to do with the taxpayer status of that corporation.

<sup>3</sup> In support of this proposition, at least two of the amici refer to section 25102 of the California Revenue and Taxation Code. However, the authority for requiring a combined report in the case of two or more corporations engaged in a unitary business is derived from section 25101 of the Code, not section 25102. See, e.g., *Edison California Stores v. McColgan*, 30 Cal. 2d 472, 480, 183 P. 2d 16 (1947) (construing predecessors of sections 25101 and 25102). Section 25102, which contains language similar to that of section 482 of the Internal Revenue

Code, is just plain wrong. As previously explained, California uses the three-factor apportionment formula set forth in the Uniform Division of Income for Tax Purposes Act ("UDITPA"). This formula consists of three fractions. The numerators of the fractions reflect the property, payroll and sales of the unitary business within the taxing state, while the denominators reflect the property, payroll and sales of the unitary business everywhere. In describing what goes into the denominator of each fraction, UDITPA uses the term "taxpayer" to refer to the entire unitary business encompassed within a state's apportionment provisions, e.g., "... the denominator of [the sales factor] is the total sales of the taxpayer everywhere during the income year." California applies the apportionment provisions of UDITPA not only when a unitary business is conducted by a single corporation, but also when such a business is conducted in a multi-corporate form. Consequently, under California law, the term "taxpayer" in the UDITPA provisions describing the denominators of the fractions necessarily refers to all components of the unitary business if more than one corporation is involved. Imperial is claiming, in short, that the unitary business which it heads is the "taxpayer" for assessment purposes simply because the denominators of the fractions reflect the total property, payroll and sales of that unitary business. On the contrary, the taxpayers for assessment purposes here are the corporations whose California factors go into the *numerators* of the fractions.

Alcan similarly claims that its subsidiary is not the "actual" taxpayer because California admittedly taxes a portion of the unitary income. According to Alcan, this means that the California tax is imposed on the income of the unitary business, not on the income earned by the subsidiary in California. The argument has several obvious flaws. First, it disregards the fact that this Court repeatedly has upheld the unitary business/formula appor-

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Code, authorizes the board to require a combined report or make other adjustments in reported income or deductions when necessary "to reflect the proper income" of "two or more persons . . . owned or controlled directly or indirectly by the same interests." It does not pertain to the combined report required in a unitary situation and makes no reference at all to the California "taxpayer."

tionment method of accounting as a fair and proper method of determining the amount of unitary income attributable to the *in-state* activities of a component of a unitary business. See, *infra*, at 7. Second, the argument assumes that it is possible to pinpoint the geographic source of particular items of unitary income—a proposition rejected not only in *Container*, but in every other case in which this Court has upheld the use of formula apportionment as applied to a unitary business. Third, and finally, the argument offers no explanation for treating the entire unitary business as the “actual” taxpayer merely because an *apportioned share* of the unitary income earned by the business as a whole is attributed to a jurisdiction in which one component of the unitary enterprise does business.

Respondents and their amici further attempt to discredit the taxpayer status of the domestic subsidiaries by arguing that the California tax is imposed on income earned by other components of the unitary business outside the state. This argument is subject to flaws already noted above. In addition, the results reached by the use of formula apportionment cannot be impeached simply upon a showing that they differ from the results reached under the separate accounting/arm’s length method of accounting. See, e.g., *Container*, *supra*, at 181-182. It would be contrary to the logic of the *Container* decision to conclude that respondents may impeach the taxpayer status of their subsidiaries by asserting that, according to the separate accounting/arm’s length method of accounting, California is taxing the income of the parents and their subsidiaries doing business in foreign countries.

It is also argued that respondents should be elevated to the role of “taxpayers” because the economic burden of the California taxes falls on the parent companies or the unitary businesses as a whole. But even assuming that what is said about the economic burden of the taxes is true, it by no means follows that either the parent companies or the unitary businesses as a whole are the “actual” taxpayers. As *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) demonstrates, the taxpayer for standing purposes is the party against whom the taxes are assessed; this status is not lost merely because the economic burden is ultimately borne by a third party.

## B. The basic fairness of California’s unitary business/formula apportionment method of accounting is settled

A number of arguments made by respondents and their amici with respect to the parent companies’ standing in this matter constitute an attack on the unitary concept and the use of formula apportionment generally. Such an attack on the unitary approach comes too late.

Nearly 70 years ago, in *Underwood T’Writer Co. v. Chamberlain*, 254 U.S. 113 (1920), this Court approved the use of formula apportionment to determine the locally taxable income of a corporation engaged in a multistate unitary business, saying that in such an instance the taxing state is “faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders.” *Id.*, at 121. Since then, the Court time and again has upheld formula apportionment as a reasonable and valid means of determining the amount of income of a unitary business fairly attributable to sources within a particular taxing jurisdiction—including income derived from such a business conducted on a multinational scale. See, e.g., *Bass, Etc., Ltd. v. Tax Comm.*, 266 U.S. 271 (1924); *Butler Bros. v. McColligan*, 315 U.S. 501 (1942); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980); *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980); *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983).

In particular, this Court said in *Container* that California’s application of the unitary business/formula apportionment method of accounting to a domestic company with foreign subsidiaries was a “proper and fair method of taxation;” that the three-factor formula employed by California has become “something of a benchmark against which other apportionment formulas are judged” because “payroll, property, and sales appear in combination to reflect a very large share of the activities by which value is generated;” that the separate accounting/arm’s length method of taxation “often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise;” and that proffered evidence of distortion under the unitary method, as allegedly

shown by separate accounting figures, "does not come close to impeaching the basic rational behind the three-factor formula" because such evidence is "based on precisely the sort of formal geographic accounting whose theoretical weaknesses justify resort to formula apportionment in the first place." 463 U.S., at 184, 170, 183, 164, 181-182.

Although ostensibly directed to the standing question, a number of arguments made by respondents and their amici dispute these findings. One amicus declares that California's three-factor formula, which the Court in *Container* termed a "benchmark," was chosen by California to "ensure[ ] income distortion in favor of its own economy." Brief of the Union of Industrial and Employers' Confederations of Europe, et al. ("Union Brf."), at 9. Another amicus, taking issue with the *Container* description of the shortcomings of the separate accounting/arm's length method of taxation, states that "in no case is income apportioned on an arbitrary basis under AL/SA." Brief of the Government of the United Kingdom, at 4. Still another amicus (in a convoluted effort to restrict its argument to the question presented for review) contends that "The application of a unitary tax 'upstream' to a foreign parent presents special problems not previously addressed by the Court in its review of 'downstream' applications of a unitary tax, and those problems further support a finding of standing." Brief Amicus Curiae of Shell Petroleum N.V. ("Shell Brf."), at 19. The theory of that amicus is that values derived from the conduct of a unitary business, such as economies of scale, flow only "downstream." *Id.*, at 21. This is not true; values can flow "upstream" as well as down. Alcan's U.S. operations provide a case in point. In interviews granted to *Forbes* magazine in the 1960's, Nathanael Davis, president of Alcan Aluminium Ltd., explained that the company had established "captive fabricating outlets" in the United States and elsewhere to provide guaranteed markets for its smelted aluminum, the idea being that the demands for smelted aluminum by such outlets

would help absorb the overhead costs of Alcan's smelters in Canada.<sup>4</sup>

In sum, the protestations of respondents and their amici must be kept in perspective. This Court determined in *Container* that the apportionment formula used by California meets the standard of fairness "under both the Due Process and Commerce Clauses." *Container, supra*, at 169; emphasis added. It also held in *Container* that California's use of the apportionment method in calculating the locally taxable income of a domestic company with foreign subsidiaries withstood the additional scrutiny required when foreign commerce is involved.<sup>5</sup> The question left

<sup>4</sup> See *Aluminium Limited: Modifying the Grand Design*, *Forbes* (April 15, 1963), at pp. 20-24; *Counterattack*, *Forbes* (August 1, 1967), at pp. 24-25; *Defensive Standoff*, *Forbes* (February 15, 1969), at p. 59.

<sup>5</sup> Imperial suggests that the *Container* decision established the proposition that any state tax imposed on an instrumentality of commerce owned by a foreign corporation is constitutionally invalid if it presents a risk of double taxation. See Brief for Respondent Imperial Chemical Industries PLC ("Imperial Brf."), at 8. *Container*, first of all, did not even involve a tax imposed on a foreign-owned instrumentality of commerce. More importantly, the *Container* court distinguished *Japan Line, Ltd. v. Los Angeles County*, 441 U.S. 434 (1979) not only on the two grounds discussed by Imperial, see Imperial Brf., at 9, but also on a third ground: that *Japan Line* involved a tax on property, while *Container* involved a tax on income. 463 U.S., at 187-188. With respect to the issue of double taxation, the Court stated that if language used in *Japan Line* were to be interpreted as establishing "an absolute prohibition on state-induced double taxation in the international context, then our analysis here would be at an end." *Id.*, at 189. The Court continued:

"But in fact such an absolute rule is no more appropriate here than it was in *Japan Line* itself, where we relied on much more than the mere fact of double taxation to strike down the state tax at issue. Although double taxation in the foreign commerce context deserves to receive close scrutiny, that scrutiny must take into account the context in which the double taxation takes place and the alternatives reasonably available to the taxing State." *Ibid.*; emphasis added.

Alcan says that the distinction which the Court drew in *Container* between a property tax and a tax on income "represent[s] a complete

undecided was whether, despite its basic fairness, the unitary business/formula apportionment method of accounting, due to Foreign Commerce Clause considerations, is constitutionally impermissible when applied either to foreign corporations or to domestic corporations with foreign parents. *Id.*, at 189, n. 26.

## II

### THE CONSTITUTIONALITY OF THE UNITARY BUSINESS/FORMULA APPORTIONMENT METHOD OF ACCOUNTING AS APPLIED TO THE DOMESTIC SUBSIDIARY OF A FOREIGN PARENT SHOULD BE LITIGATED BY THE DOMESTIC SUBSIDIARY, WHICH IS THE PARTY DIRECTLY INJURED BY THE ACTIONS OF THE TAXING AUTHORITIES

#### A. Stockholder standing is resolved by determining whether distinct legal rights exist, not by determining the merits

The central theme of the arguments presented in support of the parent companies' standing in this matter is that California's application of the unitary business/formula apportionment method of accounting to their domestic subsidiaries results in the imposition of burdens on the parent companies which are different from the burdens imposed on the subsidiary-taxpayers. This is not really the point. Under the particular rule applicable to the standing of corporate stockholders, a stockholder may complain of actions taken against the corporation only when he holds a legal right or interest which is distinct from any legal right held by the corporation. Thus, a stockholder may challenge actions against a corporation when (1) he is injured in a capacity other than that of a stockholder, as where a special duty is owed to the stockholder personally, or (2) he is injured in his capacity as a stockholder, but the corporation itself is not injured, in which case only the stockholder's rights or interests are at stake. *Cowin v. Bresler*, 741 F. 2d 410, 415 (D.C. Cir. 1984); cf., *American Power & Light Co. v. S.E.C.*, 325 U.S. 385, 388-391 (1945). It is clear in the present case that the subsidiaries themselves are directly injured by the

misunderstanding of the nature of property taxation." Alcan Brf., at 34. The Board will leave it to Alcan to carry on that debate with the Court.

actions of the Board which are claimed to injure the parent companies. Accordingly, the parent companies may challenge these actions only if they are injured in a capacity other than as corporate stockholders. See, e.g. *Schenley Corp. v. United States*, 326 U.S. 432, 435 (1946) (parent company asserting only its stockholder's derivative rights "is adequately represented for purposes of suit by the subsidiary whose conduct of the litigation it controls"). This, in turn, depends on whether the parent companies hold legal rights distinct from those held by their subsidiaries.<sup>6</sup>

Alcan's assertion that "it is simply impossible to resolve the standing issue without resolving the fundamental constitutional issue," Alcan Brf., at 17, is clearly incorrect. As this Court reaffirmed just last term, standing "'in no way depends on the merits of the [claim].'" *Asarco, Inc. v. Kadish*, \_\_\_\_ U.S. \_\_\_\_, 109 S. Ct. 2037, 2049 (1989) (quoting *Warth v. Seldin*, 422 U.S. 490, 500 (1975)); brackets in original. Thus, whether the parent companies have standing does not depend on the legality of California's method of taxation; their standing goes to the question of whether they have legal rights distinct from those of their subsidiaries. To put it a different way: the parent companies' subsidiaries are directly injured by the assessments of additional taxes, whether or not those assessments are constitutionally infirm. Conversely, even if it is assumed that California's method of taxation violates the Foreign Commerce Clause, this does not

<sup>6</sup> A stockholder bringing suit in federal court to challenge actions against the corporation in which he holds an interest must, of course, also satisfy the "injury in fact" requirement under Article III. The Court of Appeals held in this case that the parent companies' "ownership interests in their domestic subsidiaries alone" was a sufficient basis for concluding that the parent companies suffer "injury in fact" as a result of California's method of taxing their domestic subsidiaries. Pet. App., at A5-6. Assuming this is correct, respondents must still deal with the long-established stockholder standing rule, which is analogous to, but a more particularized version of, the prudential standing rule that "the plaintiff generally must assert his own legal rights and interests, and cannot rest his claim to relief on the legal rights of third parties." *Warth v. Seldin*, 422 U.S. 490, 499 (1975).

establish a direct injury to the parent companies for standing purposes. It would therefore be unnecessary (and clearly improper) for a court to resolve the merits of the constitutional claims under the guise of determining whether the parent companies have standing to raise the constitutional issues in the first place. Alcan has confused the direct injury which must be shown for standing purposes with the "ultimate injury" entailed by an unlawful invasion of legal rights.

Similarly, Alcan is mistaken when it asserts that "if Respondent has no standing, this Court has effectively decided the foreign commerce issue." Alcan Brf., at 17. The constitutionality of California's method of taxation does not depend on whether the parent companies are directly injured; it depends on whether *any* burdens imposed by that method of taxation are such as to interfere with the power of Congress to regulate foreign commerce.

**B. All of the alleged injuries to the parent companies result from actions taken against the subsidiaries; thus, without more, the injuries are clearly "derivative"**

It should be beyond dispute that all of the alleged injuries to the parent companies result from the actions taken against their domestic subsidiaries and therefore are "indirect" or "derivative," at least in that sense.

California has not imposed any taxes on either Alcan or Imperial and has no intention of doing so. If California's method of taxing their domestic subsidiaries results in double taxation of income "earned" by the parent companies or their foreign subsidiaries, this alleged double taxation arises from actions taken against the domestic subsidiaries, namely, from the inclusion in the measure of their subsidiaries' California tax liability of income also taxed elsewhere. Similarly, California has made no informational demands on either Alcan or Imperial and has no intention of doing so. Such demands have been directed only to the domestic subsidiaries. Thus, to the extent that the parent companies have assumed any compliance burdens, they have done so as volunteers, presumably in order to protect the value of their investments. See *EMI Ltd. v. Bennett*, 739 F. 2d 994, 996 (9th

Cir. 1984), cert. den., 469 U.S. 1073 (1984). These burdens are not only incidental to the demands made on the subsidiaries; they are self-imposed.

The derivative nature of the injuries alleged by respondents can be illustrated by a simple hypothetical. Suppose that California made the mistake of including the worldwide income of a totally unrelated foreign corporation in the formula for calculating the California taxes of Alcan's domestic subsidiary, Alcancorp. On the assumption that the worldwide income of the unrelated foreign corporation had been fully taxed by its home country, and that California were to ask Alcancorp for detailed information as to that foreign corporation's business activities, would the unrelated foreign corporation be injured in such a way as to give it standing to challenge the California taxes? Of course not; it could sit on the sidelines, do absolutely nothing about Alcancorp's California taxes, and never be affected by California's actions.

Clearly, Alcan and Imperial are in a different position than the unrelated corporation in the above hypothetical. However, as the hypothetical illustrates, it is not the inclusion of their income in the California formula or California's request for information about their business activities that causes any injury to the parent companies; it is their links as shareholders to their California taxpayer-subsidiaries. Under the stockholder standing rule, such shareholder links cannot form a bridge to establish standing. Thus, requisite standing is lacking on the asserted grounds of double taxation and excessive compliance burdens unless there is some reason for deviating from the rule.

Imperial asserts that double taxation also occurs when a foreign parent company is denied a tax credit by its domiciliary country with respect to dividend payments made by its domestic subsidiary. But again this double taxation, if it occurs at all, results indirectly from the inclusion in the measure of the subsidiary's California tax liability of income which is considered (under the separate accounting approach) to be earned elsewhere. Furthermore, the record establishes that the alleged dividend "injury" to Imperial simply does not exist. Exhibit 19 to the Joint Stipulation of Facts in the Imperial case establishes that no dividends have been paid by Imperial's domestic subsidiary during any of the

years in question and "no occasion" for a claim by Imperial for such a credit "has therefore yet arisen. . . ." Exh. 19, at 5. Imperial rests its claim of injury on an opinion of "what the attitude of the Commissioners would be to a claim for such credit in relation to California franchise tax paid by ICI Americas Inc [sic] in the years in question, *when and if* dividends are declared." *Id.*, at 5-6; emphasis added. As this Court has made clear with respect to the "injury in fact" requirement of Article III, allegations of economic harm sufficient to demonstrate such an injury must be distinct and palpable; they cannot rest on "hypothetical assumptions." *Asarco, Inc. v. Kadish, supra*, 109 S. Ct., 2043.<sup>7</sup>

As for the alleged burden on the parent companies' decision-making, it is highly questionable whether this is a cognizable injury at all (see below). But assuming that such a burden is a cognizable injury, it too results from actions taken against the domestic subsidiaries, not against the parent companies. If California burdens the decision-making of the foreign parents, plainly it is because of the manner in which California calculates the subsidiaries' taxable income.

Without more, then, it is clear that all of the alleged injuries are "derivative" in character. In addition, the fact that the parent companies may suffer different injuries than the subsidiaries is not decisive in determining whether the parent companies have "direct" injuries for standing purposes, or instead are resting their claims on the legal rights of their subsidiaries. A stockholder seeking to challenge actions taken against the corporation in which he holds an interest may proceed against the alleged

<sup>7</sup> Imperial clearly exaggerates the situation when it claims that because it can never obtain a U.K. credit for the California taxes assessed and collected for the three loss years of Americas (1972, 1973, and 1975), this illustrates "economic double taxation in its purest form." Imperial Brf., at 15-16. Dividends can never be paid out of the earnings of the subsidiary in 1972, 1973, or 1975 since, according to its own books of account, Americas realized losses in those years. It follows that double taxation will never result from the denial of a U.K. credit with respect to the three reported loss years since the U.K. would never tax non-existent dividends in the first place.

wrongdoer only upon a showing that he has distinct legal rights at stake. The Board will address that issue in the context of the present case, see *infra*, at 18-20, after first considering in greater detail the alleged burden on the parent companies' decision-making.

**C. The alleged burden on the parent companies' decision-making is not a cognizable injury, whether it be considered direct or indirect**

The Court of Appeals held that California's method of taxation burdens the decision-making of foreign companies by tending to "penalize foreign ownership of American assets." Pet. App., at A15. The court appeared to reach this conclusion on the basis that if foreign companies conduct their commerce through domestic subsidiaries, the overall tax burden will be potentially *greater* than if the companies were to conduct precisely the same foreign commerce through arm's length contracts with unaffiliated companies. *Id.*, at A15-16. Indeed, the Court of Appeals' holding makes absolutely no sense unless it was under the mistaken impression that a tax liability would be incurred if the foreign companies conducted commerce through unaffiliated companies, but that any liability so incurred would be determined under the separate accounting/arm's length approach. This suggests yet another reason why state tax cases initially should be tried in the state courts, which are more familiar with the workings of state tax law.

To repeat what the Board has pointed out earlier: If foreign companies were to conduct their foreign commerce in California through independent contractors, it is unlikely that any tax liability would be incurred in connection with the unitary businesses headed by the foreign companies.<sup>8</sup> It would be preposterous to say that there is a burden on a foreign company's decision-making when it is put to the choice of either (1) doing business in

<sup>8</sup> Furthermore, in the unlikely event that some tax liability would be incurred, that liability would be determined under the unitary business/formula apportionment method of accounting, not the separate accounting/arm's length approach. See Brief for the Petitioners, at 27-29.

a state directly through branch operations or indirectly through a subsidiary, thereby making some component of its unitary business amenable to state taxation, or (2) not doing business in the state, thereby insulating any portion of the unitary business from state taxation. In short, California's tax "penalizes" a foreign company for conducting its commerce through a domestic subsidiary only in the sense that such a subsidiary, by conducting business activities within the state, would necessarily become amenable to taxation. It is not California's method of taxation that "penalizes" the ownership of a domestic subsidiary doing business in California, but *any* tax imposed on that subsidiary.

Alcan appears to be as confused as the Court of Appeals. It argues that California's method of taxation has "effectively deprived foreign parents of the tax benefits of operating in commerce through the vehicles of subsidiaries" as opposed to operating directly in the United States. Alcan Brf., at 14-15. Alcan further states:

"It was the expectation of Respondent when it invested in the United States that if it entered the United States through a subsidiary, the only impact it would see on its non-U.S. activities would follow exclusively through its shareholder status. Respondent did not expect every activity it conducted outside the United States would influence liability for California income tax." *Id.*, at 9.

What all of this apparently means is that Alcan realized it might be taxed on a unitary basis if it had branch operations in the United States,<sup>9</sup> but it expected to avoid any unitary treatment by setting up a subsidiary. However, Alcan's subsidiary began operations in California some 20 years after the California Supreme Court held in *Edison California Stores v. McColgan*, 30 Cal. 2d 472, 183 P. 2d 16 (1947) that the state's law regarding the formula apportionment of income derived from a unitary business is applicable whether that business is carried on by a single corporation or two or more affiliated corporations. Under these

<sup>9</sup> The use of formula apportionment in this situation was upheld by the Court in *Bass, etc., Ltd. v. Tax Comm.*, 266 U.S. 271 (1924) (United Kingdom corporation with branch operations in New York).

circumstances, Alcan has no basis for complaining that California unexpectedly has denied it the "tax benefits" of conducting commerce through a subsidiary rather than through a branch.<sup>10</sup>

Finally, if California's method of taxation ever constituted a significant burden on the decision-making of foreign companies, that is no longer true. Under a law enacted in 1986, which became effective on January 1, 1988, components of a multinational unitary business may now calculate their tax liabilities under a "water's edge election." See Cal. Rev. & Tax. Code § 25110 et seq.<sup>11</sup> Thus, foreign parent companies hardly are under stress when it comes to deciding whether to conduct their commerce in California through domestic subsidiaries. If they make that choice, *they* can now determine whether foreign factors will be taken into account.<sup>12</sup>

<sup>10</sup> Alcan also claims that its status as the sole stockholder of its domestic subsidiary "is being ignored for the purpose of calculating the California tax," and that having ignored Alcan's stockholder status, the Board "cannot now rely on that status to avoid being challenged for having ignored it in the first instance!" Alcan Brf., at 8-9. California has not ignored the stockholder, i.e., ownership, status of Alcan. A bond of ownership or control is essential to the finding of a unitary business. *Container, supra*, at 166.

<sup>11</sup> Under these circumstances, the note of hysteria that has crept into some of the briefs is uncalled for. See, e.g., Alcan Brf., at 44, n. 22 ("This Court should not be lulled into complacency because actual retaliation has not occurred. International restraint has been exercised because of the recognition of the catastrophic consequence of retaliation and the difficulty of stopping it."); Union Brf., at 9 ("The real danger in California's tax method is that it may cause international trade barriers that took more than forty years to dismantle to be reinstated").

<sup>12</sup> The legality of California's method of taxation for years prior to the enactment of the "water's edge" legislation is at issue in a case currently pending in the California Court of Appeal, *Barclays Bank International Ltd. v. Franchise Tax Board* (3rd Dist., No. C 003388). This case, in which both a foreign parent and its domestic subsidiary are plaintiffs, presents all of the issues relevant to the constitutionality of California's unitary business/formula apportionment method of accounting as applied to a domestic subsidiary of a foreign parent.

**D. The parent companies do not hold legal rights distinct from those of their domestic subsidiaries**

Respondents argue that they hold legal rights distinct from those of their domestic subsidiaries because, as Imperial puts it, the subsidiaries, unlike their parent companies, are "not within the class of foreign investors protected by federal foreign commerce policy." Imperial Brf., at 24. In other words, respondents persist in taking the position that their domestic subsidiaries cannot raise claims under the Foreign Commerce Clause because they are not engaged in foreign commerce. The Court of Appeals aptly characterized this theory as "idiosyncratic." Pet. App., at A4, n. 4. Respondents insist that California's method of calculating the taxable income of their domestic subsidiaries is subject to constraints imposed by the Foreign Commerce Clause because the domestic subsidiaries constitute "instrumentalities of foreign commerce." They cannot be heard to argue at the same time that the subsidiaries are not engaged in foreign commerce and hence may not claim protections under the Foreign Commerce Clause.

Although the Court of Appeals rejected respondents' "idiosyncratic" theory, it proceeded to determine, in effect, that the foreign parent companies hold legal rights distinct from those of their subsidiaries because "the subsidiaries are owned as instrumentalities of the foreign commerce of their parents." Pet. App., at A15. In the court's view, the parent companies have distinct legal rights as the owners of these instrumentalities of commerce and thus are not injured solely in their capacity as corporate stockholders. But surely the mere fact that the subsidiaries may be owned as instrumentalities of foreign commerce cannot mean that the parent companies have standing to complain of any actions which are taken against the subsidiaries and hence burden the conduct of the parents' foreign commerce. As the Board previously has pointed out, every wholly-owned subsidiary can be viewed as an instrumentality by which its parent company conducts one type of commerce or another. If the ownership of a subsidiary as an instrumentality of commerce were deemed sufficient to create an exception to the traditional standing rule prohibiting individual actions by corporate stockholders, the exception would swallow the rule.

Respondents assert that there is no danger of the exception swallowing the rule—and hence that the concerns expressed by the Board's amici are unfounded—because, as Imperial states, "It is impossible to conceive of another set of facts or a taxing regime other than the Board's application of California's unitary method that would, in combination, permit an action of this nature in federal court." Imperial Brf., at 28; see also Alcan Brf., at 48-49. According to Imperial, the decision of the Court of Appeals deals only with the standing of a *foreign* parent and sets forth three elements which must be present for standing to exist: (1) an area of recognized federal supremacy; (2) the absence of an affirmative policy permitting state intrusion in the area of concern; and (3) the lack of any remedy for the parent in the state courts. Imperial Brf., at 29. The Court of Appeals did not spell out these conditions. Furthermore, even if the conditions can fairly be implied from the Court of Appeals' holding on the standing issue, they are as applicable to the broad range of tax matters involving interstate commerce as to the particular Foreign Commerce Clause issues presented by the unitary tax system.<sup>13</sup> Finally, if the Court of Appeals' rationale is to be limited to *foreign* parent

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<sup>13</sup> The Court of Appeals' holding that a burden on the decision-making of a parent company is a sufficient "injury" for standing purposes would also be applicable in cases involving neither foreign commerce nor the unitary method of taxation. Assume, for example, that a state were to adopt a sales tax reporting system which, while only based on sales made within that state, was different from all other states' systems. A U.S. corporation which chose to make sales in that state through a subsidiary would be required to incur the expense of developing new expertise in its tax compliance staff, an expense that could be avoided if the parent company sold its goods in the state through an independent contractor. Under the Court of Appeals' reasoning, the burden upon the commerce decisions of the parent corporation, particularly if the states' sales tax system allegedly discriminated against the type of business conducted by the corporation, would constitute an "injury" giving the out-of-state nontaxpayer corporation standing to challenge the constitutionality of that state's sales tax statute.

companies, the latter inexplicably are given an advantage not possessed by parent companies organized in the United States.<sup>14</sup>

Also perplexing is respondents' underlying thesis that, while they are foreign corporations doing business exclusively outside the United States, they hold rights under the Commerce Clause that are not only distinct from, but more expansive than, the rights held by the subsidiary companies that are organized under the laws of this country. Aside from the anomaly, it is clear that the Commerce Clause is not the source of "individual" rights as such, see *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 127-128 (1978), and therefore the foreign parents do not have rights under the Commerce Clause that are peculiar to them. Thus, any constitutional objections the parent companies may have to California's method of taxation are shared with the taxpayer-subsidaries. Stated another way, the parent companies, at the most, have a "right" to engage in foreign commerce in the United States through subsidiaries without those subsidiaries being subjected to a tax which violates the Foreign Commerce Clause. The interests of the subsidiaries as the "instrumentalities of the foreign commerce of their parents" are the same.

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<sup>14</sup> One of the amici for respondents states that the very denial of standing in this case "places an added burden on international commerce that a domestic parent does not have to face, because a domestic parent will always have standing, as the nominal taxpayer, in some American court." Shell Brf., at 15. This is incorrect for the simple reason that a domestic parent is not always what is termed the "nominal" taxpayer. The taxpayer is the entity subject to California taxes. When that entity is a subsidiary of a parent company which does business exclusively outside the state, the subsidiary is the only "nominal" taxpayer. See, e.g., *Edison California Stores v. McColgan*, 30 Cal. 2d 472, 183 P. 2d 16 (1947); *Chase Brass & Copper Co. v. Franchise Tax Board*, 10 Cal. App. 3d 496, 95 Cal. Rptr. 805 (1970), cert. den., 400 U.S. 961 (1970). Thus, the parent company in such a case could not challenge a tax assessment against the subsidiary in the California courts. It would also be precluded from challenging the assessment in the federal courts or in the courts of any other state—or at least that was the general understanding prior to the issuance of the decision under review.

### III

#### **EVEN IF THE PARENT COMPANIES CAN BE VIEWED AS SUFFERING DIRECT INJURIES AS A RESULT OF CALIFORNIA'S METHOD OF TAXING THEIR DOMESTIC SUBSIDIARIES, THE PARENT COMPANIES SHOULD BE REQUIRED TO PURSUE THEIR CONSTITUTIONAL OBJECTIONS THROUGH THE STATE REMEDIES EFFECTIVELY AVAILABLE TO THEM**

##### **A. Respondents and their amici have not advanced any plausible basis for their assertion that the available state remedies are inadequate**

The Tax Injunction Act (28 U.S.C. § 1341) prohibits the district courts from intervening in state tax matters "where a plain, speedy and efficient remedy may be had in the courts of such State." The Board's argument in this case is that respondents effectively have such remedies due to their total control over the pursuit of state remedies by the taxpayer-subsidaries. In essence, the principal counter-arguments of respondents and their amici run as follows: (1) the domestic subsidiaries cannot challenge the tax assessments on Foreign Commerce Clause grounds because they are not engaged in foreign commerce; (2) assuming that the domestic subsidiaries can claim protections under the Foreign Commerce Clause, they are not in a position to complain of the burdens allegedly imposed on their parent companies, or at least whether they can do so is entirely speculative; and (3) in any event, if the parent companies suffer direct injuries, they are entitled to their own day in court.

The assertion that the domestic subsidiaries cannot raise claims under the Foreign Commerce Clause because they are not engaged in foreign commerce is illogical in view of the respondents' basic premise that the subsidiaries constitute "instrumentalities of foreign commerce." See, *supra*, at 18. The assertion is also illogical for another reason. To say that a taxpayer is powerless to raise constitutional objections to a tax which *it* is required to pay is tantamount to saying that a taxpayer must abide by a tax assessment even though it is constitutionally invalid. Very simply, this makes no sense.

Nor does it make sense to assert that the subsidiaries in the present matter cannot complain of any burdens on the conduct of foreign commerce which may be considered to fall directly on the parent companies. Imperial, for example, states that if, as the Board contends, a shareholder has no standing to litigate claims based on injury to the corporation, "it follows with equal or greater force that a corporation has no standing to raise claims based on injury to its shareholders." Imperial Brf., at 25-26. That may be true where actions against a shareholder do not directly injure the corporation. But just as a stockholder can complain of actions against a corporation which directly injure the stockholder, it should be clear that a corporation can complain of actions against a stockholder which directly injure the corporation. Beyond question, a corporate taxpayer is directly injured by an assessment of taxes in addition to those reported as due. It necessarily follows that legal rights of respondents' subsidiaries are at stake here. Furthermore, any injury to the parent companies in the present case raises precisely the same legal issue as the injury to their subsidiaries: Does California's method of calculating the taxable income of the subsidiaries interfere with Congress' power to regulate foreign commerce?

It is nonetheless asserted that whether a state court would permit the domestic subsidiaries to complain of the burdens imposed on their parent companies is entirely "speculative" and that "A speculative remedy is not a plain, speedy and efficient remedy within the meaning of the [Tax Injunction] Act." Brief of the Committee of London and Scottish Bankers ("Bankers Brf."), at 4. Actually, however, it is respondents who are asking this Court to engage in unwarranted speculation: that a state court will not apply constitutional principles as enunciated by this Court. In *Japan Line, Ltd. v. Los Angeles County*, 441 U.S. 434 (1979), the Court held that when a state seeks to tax instrumentalities of foreign commerce, two additional considerations, beyond those articulated in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977),<sup>15</sup> come into play: "the enhanced risk of

<sup>15</sup> The Court held in *Complete Auto Transit* that a state tax will survive challenge under the Interstate Commerce Clause if the tax "[1] is applied to an activity with a substantial nexus with the taxing State,

multiple taxation" and the possibility that such a tax may "impair federal uniformity in an area where federal uniformity is essential." 441 U.S., at 446, 448. In *Container*, the Court held that this additional scrutiny is required when a state tax case involves a unitary business that is international in scope. 463 U.S., at 185. It cannot be presumed that, when confronted with a tax case involving a multinational enterprise, a state court will decline to follow the mandate of this Court and refuse to consider the issues raised by the Foreign Commerce Clause, i.e., whether the disputed tax creates an impermissible risk of double taxation or violates the "one voice" standard.<sup>16</sup>

For Alcan to make such a claim is particularly inappropriate. Currently pending in the California courts are two suits for refund filed by Alcan's wholly-owned subsidiary, one of which dates back to 1977. Alcan Stip., ¶ 36, Exh. XIX-1 and 2. Rather than having its subsidiary pursue those actions—and thus putting to a test its theory that the subsidiaries cannot raise claims under the Foreign Commerce Clause, Alcan has permitted the actions to languish in the state courts while it has gone from one circuit to another in search of a receptive federal forum.<sup>17</sup> Apropos here is the follow-

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[2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State." 430 U.S., at 279.

<sup>16</sup> As previously pointed out, see *supra*, at n. 12, both of these issues are under consideration in *Barclays Bank International Ltd. v. Franchise Tax Board* (3rd Dist. No. C 003388), which is currently pending in the California Court of Appeal.

<sup>17</sup> Alcan audaciously claims that, despite the fact that Alcan filed this action in the Seventh Circuit after the Second Circuit rejected Alcan's claim of standing in *Alcan Aluminum Ltd. v. Franchise Tax Board*, 558 F. Supp. 624 (S.D.N.Y. 1983), *aff'd mem.*, 742 F. 2d 1430 (2d Cir. 1983), *cert. den.*, 464 U.S. 1041 (1984), the charge of "forum shopping" by one of the Board's amici "is not supported by the facts." Alcan Brf., at 49, n. 25. What except "forum shopping" explains the Illinois situs of the second suit? It is also to be noted that there appears to be no other explanation for the filing of Imperial's action in Illinois. Logically the action would have been filed either in California or New York, where the Board's audit of the domestic subsidiary was conducted.

ing statement in *Pennzoil Co. v. Texaco, Inc.*, 481 U.S. 1, 15 (1987), where the complaining party asserted that the Texas courts would not entertain its constitutional claims:

"[D]enigrations of the procedural protections afforded by Texas law hardly come from Texaco with good grace, as it apparently made no effort under Texas law to secure the relief sought in this case. (Citation omitted.) Article VI of the United States Constitution declares that 'the Judges in every State shall be bound' by the Federal Constitution, law, and treaties. We cannot assume that state judges will interpret ambiguities in state procedural law to bar presentation of federal claims. (Citation omitted.) Accordingly, when a litigant has not attempted to present his federal claims in related state-court proceedings, a federal court should assume that state procedures will afford an adequate remedy, in the absence of unambiguous authority to the contrary."

In this case, unlike *Pennzoil*, the complaining parties do not have direct remedies in the state courts for airing their grievances. However, the taxpayer-subsidaries have access to the state courts to air the *same* grievances. The parent companies, as the sole stockholders of the domestic subsidiaries, have full control over the pursuit of state remedies by the actual taxpayers. It therefore defies reason to contend, as do respondents, that the parent companies effectively have no remedies in the state courts. Cf., *South Carolina v. Regan*, 465 U.S. 367, 381, n. 19 (1984).<sup>18</sup> Any

JA 43. Both the Ninth and Second Circuits, however, had already ruled that foreign parent companies lack requisite standing to challenge taxes imposed on their domestic subsidiaries.

<sup>18</sup> The assertion that the *South Carolina* case supports respondents' position, rather than the Board's, completely ignores the reasoning of the decision. The Court pointed out that if the aggrieved party in that case were denied injunctive relief, it "would be required to depend on the mere possibility of persuading a third party to assert [its] claims." 465 U.S., at 381. A parent company does not have to exercise any powers of persuasion over a wholly-owned subsidiary.

One amicus also suggests that the *South Carolina* case is distinguishable because "the Tax Injunction Act [does] not contain the third party prohibition of the Anti-Injunction Act." Bankers Brf., at 14. While this

claim that the parent companies are better equipped than their subsidiaries to litigate the constitutional issues is also at odds with reality. The subsidiaries, through their house counsel, have represented the parent companies at every stage of the federal litigation. They are as prepared to litigate the constitutional issues as the parent companies choose to make them. Is it really asking too much to require that the battle be waged by the subsidiaries in the state courts, where the controversy rightfully belongs?

In answering that rhetorical question, the parent companies would insist that they are entitled to their own day in court. Under the circumstances of the present case, however, where the parent companies exercise total control over the subsidiaries' pursuit of state remedies, and where the state courts presumably would consider all of the Foreign Commerce Clause objections to California's tax, the insistence has a hollow ring. Cf., *Schenley Corp. v. United States*, 326 U.S. 432, 435 (1946). It amounts to little more than a claim that the parent companies are entitled to bring an action in their own names in the federal courts, rather than have the subsidiaries pursue actions in *their* names in the state courts. If the Tax Injunction Act's proscriptions hinge on that sort of technicality, its days obviously are numbered.

#### **B. The entertainment of such actions by the federal courts would frustrate the policies underlying the Tax Injunction Act**

Imperial asserts that its action in the federal courts should not be barred by the Tax Injunction Act, or by principles of federal abstention and comity, because the action "do[es] not create a risk of interference with *normal* State collection procedures." Imperial Brf., at 8; emphasis added. By way of explanation, Imperial points out that "There is no interference with California's audit and collection process vis-a-vis the income of the U.S. subsidiary, Americas, as determined under federal law and inter-

is true, the Court recognized in *Bob Jones University v. Simon*, 416 U.S. 725, 731-732, n. 6 1974 that the phrase in the Anti-Injunction Act dealing with third-party standing was "a reaffirmation of the plain meaning of . . . § 7421(a)" as it existed prior to the addition of the phrase. See also *South Carolina*, at 377-378, n. 16.

national practice." *Id.*, at 29. In other words, in Imperial's view, the policies expressed in the Tax Injunction Act apply only when the state is attempting to collect taxes which are conceded to be due (in this case, under the separate accounting/arm's length method of accounting). Upon further reflection, surely even Imperial would agree that this is carrying things a bit too far.

In keeping with the suggestion of the Court of Appeals, it is further urged that California has at its disposal a ready solution to federal intrusion in its tax matters: simply grant a remedy to the foreign parents. One amicus asks, "Why would the pressing of its suit by the litigant which has a direct injury be more disruptive to the state, particularly if the constitutional claims are, as the state contends, the same?" Bankers Brf., at 16. As the representatives of that particular amicus are well aware, Article XIII, section 32 of the California Constitution provides:

"No legal or equitable process shall issue in any proceeding in any court against this State or any officer thereof to prevent or enjoin the collection of any tax. After payment of a tax claimed to be illegal, an action may be maintained to recover the tax paid, with interest, in such manner as may be provided by the Legislature."

The policy behind this provision is the same as the policy underlying the Tax Injunction Act: "to allow revenue collection to continue during litigation so that essential public services dependent on the funds are not unnecessarily interrupted." *Pacific Gas & Electric Co. v. State Bd. of Equalization*, 27 Cal. 3d 277, 283, 165 Cal. Rptr. 122, 611 P. 2d 463 (1980). The notion that California could easily, and with good conscience, amend its Constitution to provide special equitable remedies for foreign parent companies which object to the manner in which California taxes their domestic subsidiaries is absurd.<sup>19</sup>

<sup>19</sup> The following statement of Alcan falls into the same category, and is offensive as well:

"Nor was Petitioners' failure to give Respondent a remedy an oversight. When questioned, Petitioners made it quite clear that they would never grant Respondent a remedy because in their view the tax imposed no foreign commerce burden." Alcan Brf., at 46.

A final point to be considered is the role which "international comity" plays in this case. Respondents and their amici argue in substance that the Tax Injunction Act and its underlying principle of comity should give way when a state tax has foreign repercussions. It is said that such circumstances "shift" the policy considerations "from those of 'our federalism,' which concerns balance between our states and our national government, to those of 'our nation' and its dealings with other nations." Bankers Brf., at 19. This argument insinuates that the federal policies expressed in the Tax Injunction Act conflict with the goals of "our nation" in foreign affairs. In other words, it attempts to give a new twist to the "one voice" standard. The problem with the argument, however, is that the prohibition against injunctive relief in state tax matters does not raise a conflict between state and federal policies in an area of international affairs, where the voice of the federal government is supreme. The Tax Injunction Act is a *federal* statute limiting *federal* jurisdiction over state tax matters, and the policies it reflects are policies of the *federal* government.

Furthermore, the suggestion that concerns of "our federalism" and concerns of "our nation" are polarized is incorrect. Frequently when "our nation" speaks in the area of foreign affairs it voices principles of "our federalism." That is illustrated by some of the historical facts which bear on the constitutional merits of respondents' claims. For example, as this Court observed in *Container, supra*, at 196, "the tax treaties into which the United States has entered do not generally cover the taxing activities of subnational governmental units such as States, and in none of the treaties does the restriction on 'non-arm's length' methods of taxation apply to the States." To the extent the treaties are not intended to restrict the taxing powers of the states, they reflect federalism concerns.<sup>20</sup>

Understandably, Alcan cites no authority for this accusation, either in the record or otherwise.

<sup>20</sup> In *Wardair Canada v. Florida Dept. of Revenue*, 477 U.S. 1 (1986), a case which involved a tax on fuel used by foreign airlines solely in foreign commerce, this Court held that,

"By negative implication arising out of more than 70 agreements entered into since the Chicago Convention [on International Civil

It is further urged that, in any event, foreign nations can rightfully expect that their corporations will be given access to some judicial forum within the United States in which they can complain of state taxes levied against their subsidiaries. See, e.g., Alcan Brf., at 48; Brief of the Committee on State Taxation of the Council of State Chambers of Commerce, at 3-4, 7. On the contrary, foreign nations cannot properly harbor that expectation unless corporations domestic to the United States have similar access to the courts to complain of state taxes levied against *their* subsidiaries. At best, foreign nations are entitled to *national* treatment with respect to access to the courts;<sup>21</sup> they are not entitled to preferential treatment.

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Aviation], the United States has at least acquiesced in state taxation of fuel used by foreign carriers in international travel. Again, in the U.S.-Canadian Agreement only 'national' charges are barred, and we presume that drafters from two federalist nations understood this as representing a choice not to preclude local taxation." 477 U.S., at 12.

Not surprisingly, one of the major questions raised by the controversy over California's use of formula apportionment to calculate the taxable income of a domestic subsidiary of a foreign parent is whether the nonapplicability to the states of the treaty provisions requiring the use of separate accounting represents "an omission which must be understood as representing a policy choice [of the federal government]." *Id.*, at 11.

<sup>21</sup> See, e.g., Article V, ¶ 1, Treaty of Friendship, Commerce and Navigation between the United States of America and the Kingdom of The Netherlands, March 27, 1956, reproduced in Shell Brf., at A-1.

## CONCLUSION

The Court of Appeals, both at the expense of the stockholder standing rule and at the expense of the Tax Injunction Act and its underlying principle of comity, held in this case that foreign companies have standing in the federal courts to challenge the constitutionality of the manner in which a state determines the taxable income of their domestic subsidiaries. The decision is wrong and should be reversed.

DATED: August 9, 1989

Respectfully submitted,

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OCT 18 1989

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CLERK

No. 88-1400

IN THE  
**Supreme Court of the United States**

OCTOBER TERM 1989

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FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA; LEONARD WILSON, Individually and as District Manager, Chicago Office of the Franchise Tax Board of the State of California; and B. M. Rarang, Individually and as Auditor, Chicago Office of the Franchise Tax Board of the State of California,

*Petitioners,*

v

IMPERIAL CHEMICAL INDUSTRIES PLC,

*Respondent.*

---

**ON WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS  
FOR THE SEVENTH CIRCUIT.**

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**BRIEF OF SUPPLEMENTAL AUTHORITIES  
ON BEHALF OF RESPONDENT**

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**BRIEF OF SUPPLEMENTAL AUTHORITIES  
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**INTRODUCTION**

This brief submits to the Court the texts of two letters, the first dated June 30, 1989, from Julian Santamaria, Ambassador of Spain, to the Honorable James A. Baker III; the second dated August 23, 1989, in reply from John E. Robson, Acting Secretary, to the Honorable Lorenzo Gonzalez-Alonso, Minister for Economic and Commercial Affairs, Embassy of Spain. These authorities are filed as supplements to the record pursuant to Supreme Court Rule 35.5. These authorities were not available at the time of submission of the Brief for Respondent in this cause. These letters reaffirm the present Administration's support of the previous Administration's foreign commerce policy as expressed in the Joint Appendix (pp. 123-125) and the Department of Justice *amicus curiae* brief filed in the district court, below.

**I. Letter From the European Community To The United States Government.**

EL EMBAJADOR de ESPAÑA

WASHINGTON

June 30th, 1989

The Honorable  
James A. Baker, III  
Secretary of State  
U.S. Department of State  
Washington, D.C. 2520

Dear Sir:

The Member States of the European Community have noted that the United States Supreme Court is shortly to hear an appeal against the judgement of the Seventh Circuit Court of Appeals in *Imperial Chemical Industries plc [sic] and Alcan Aluminium Limited v. California Franchise Tax Board*.

The EC Member States consider this to be an appropriate opportunity to restate their opposition to the use of worldwide unitary tax by the State of California. They would urge the United States Government to confirm that, like the previous Administration they, too, are opposed to the use of worldwide unitary tax.

The views of the EC Member States on worldwide unitary tax are well known.\* They consider that the imposition of this tax is inconsistent with the internationally accepted principles underlying the Tax Treaties and Friendship Treaties that individual Member States have entered into with the United States. Specifically, the use of the tax by the State of California:

\* Demarche of the EC Member States submitted to the U.S. Department of State; 19 March, 1980; 30 October, 1981; 29 June, 1982; 1 August, 1983; 23 September, 1983; 20 December, 1984; 8 August, 1985; 30 August, 1985.

i) contradicts the "arm's length" principal of allocating income of multi-national corporations between different national jurisdictions;

ii) may give rise to substantial double taxation;

iii) imposes a severe compliance burden by insisting on the restatement of accounts of different, but affiliated, corporations throughout the world even when they are not doing any business in California—accounts which were originally prepared to meet the specifications of the countries in which these corporations are resident;

iv) has perverse effects on the worldwide strategy of multi-national corporations (since, for example, a cost saving investment made in any country outside the U.S., can increase the tax liability in California, even if the California subsidiary is loss-making);

v) discriminates against companies doing business in California via subsidiaries, rather than through non-affiliated companies.

The EC Member States are strongly opposed to the attempt by California or any other State to impose taxation in income of foreign corporations arising outside the U.S.; to interfere with worldwide investment strategies, and to insist on burdensome compliance requirements on companies located outside the U.S.

EC Member States are aware that California has amended its legislation to allow multi-national companies to elect, on payment of a fee, to be taxed on a "water's edge", rather than worldwide unitary basis. However, since they are opposed to the use of worldwide unitary tax in principle, Member States cannot accept that it is right to insist on a fee as the price for electing to avoid worldwide unitary tax. Moreover, the process of making such an election involves substantial and unreasonable burdensome compliance costs.

The EC Member States, of course, support the case submitted by Imperial Chemical Industries and by Alcan Aluminium in the District Court and the Seventh Circuit

Court of Appeal. They also very much endorse the *amicus* brief submitted by the U.S. in the District Court in *ICI and Alcan v. California FTB*. The EC Member States are aware that the issue currently before the Supreme Court is the question of the standing of the foreign parent companies to challenge the tax in the Federal courts, rather than the constitutionality of the tax itself. However, they believe the two issues to be inextricably interlinked. The EC Member States consider that worldwide unitary tax imposes an administrative and economic burden on foreign parent corporations and breaches the arm's length standard. Since the U.S. in its double taxation convention adheres to the internationally accepted arm's length principle, application of worldwide unitary tax by separate states of the U.S. prevents the U.S. from speaking with one voice when regulating commercial relations with foreign governments, and in the opinion of EC Member States is unconstitutional. The administrative and economic burden is imposed directly on foreign corporate parents and it is this constitutionally significant burden which creates standing for those foreign parents.

The Member States note and appreciate the U.S. Government's opposition to worldwide unitary tax. Given the importance of the present case before the Supreme Court, the Member States would urge the U.S. Government to reaffirm their commitment to the position taken by the previous Administration.

Sincerely,

/s/ Julian Santamaria

Julian Santamaria  
Ambassador of Spain

## II. Response From The United States Government To The European Community.

THE SECRETARY OF THE TREASURY  
WASHINGTON

August 23, 1989

The Honorable Lorenzo Gonzalez-Alonso  
Minister for Economic and Commercial Affairs  
Embassy of Spain  
2558 Massachusetts Ave., N.W.  
Washington, D.C. 20008-2865

Dear Mr. Gonzalez-Alonso:

Thank you for your letter of June 30, 1989, enclosing a copy of the letter of the same date from Ambassador Santamaria (on behalf of the Member States of the European Community) to Secretary of State James A. Baker III.

The issue of unitary taxation remains a serious concern to the Treasury Department and, indeed, to the Administration of President Bush. Although I do not want to comment on any particular matter of pending litigation, such as the case cited in Ambassador Santamaria's letter, I want to assure you of our continuing attention to this issue. We believe that states' use of the worldwide unitary tax method may constitute an impermissible interference in the conduct of the nation's foreign affairs, and further progress is required before Federal concerns on this issue can be put to rest.

Thus, we continue to endorse strongly the position taken by the prior Administration under which President Reagan instructed the Attorney General to ensure that the United States' interests are represented in appropriate controversies and cases. We expect the Federal Government to continue to express its views on this matter when and where it is necessary and appropriate to do so.

Sincerely,

/s/ John E. Robson

John E. Robson  
Acting Secretary

**CONCLUSION**

This Court is prayed to take judicial notice of this recent expression of the foreign commerce policy of the United States Government.

Respectfully submitted,

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OCTOBER TERM, 1988

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*Petitioners,*

v.

ALCAN ALUMINIUM LIMITED and  
IMPERIAL CHEMICAL INDUSTRIES PLC,  
*Respondents.*

On Writ of Certiorari to the United States  
Court of Appeals for the Seventh Circuit

BRIEF OF THE COUNCIL OF STATE GOVERNMENTS,  
NATIONAL LEAGUE OF CITIES,  
NATIONAL CONFERENCE OF STATE LEGISLATURES,  
NATIONAL ASSOCIATION OF COUNTIES,  
U.S. CONFERENCE OF MAYORS,  
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INTERNATIONAL CITY MANAGEMENT ASSOCIATION  
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24/9/89

### **QUESTION PRESENTED**

Whether a federal court should permit the foreign parent of a domestic corporation to avoid (1) the long-standing judicial policy, embodied in the Tax Injunction Act, barring federal court interference with the normal tax processes of the States, and (2) the normal rule that a shareholder cannot sue on behalf of a corporation.

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No. 88-1400

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA;  
LEONARD WILSON, Individually and as District Manager,  
Chicago Office of the Franchise Tax Board of  
the State of California; and B.M. RARANG, Individually  
and as Auditor, Chicago Office of the Franchise Tax  
Board of the State of California,

*Petitioners,*

v.

ALCAN ALUMINIUM LIMITED and  
IMPERIAL CHEMICAL INDUSTRIES PLC,  
*Respondents.*

On Writ of Certiorari to the United States  
Court of Appeals for the Seventh Circuit

BRIEF OF THE COUNCIL OF STATE GOVERNMENTS,  
NATIONAL LEAGUE OF CITIES,  
NATIONAL CONFERENCE OF STATE LEGISLATURES,  
NATIONAL ASSOCIATION OF COUNTIES,  
U.S. CONFERENCE OF MAYORS,  
NATIONAL GOVERNORS' ASSOCIATION, AND  
INTERNATIONAL CITY MANAGEMENT ASSOCIATION  
AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

### INTEREST OF THE *AMICI CURIAE*

The *amici*, organizations whose members include state, county, and municipal governments and officials throughout the United States, have a compelling interest in legal issues that affect state and local governments.

In this era of scaled-down federal funding of programs and growing state responsibility, nothing is more compelling to the States than the ability to raise tax revenue in the manner best suited to each State's needs and circumstances. The validity of California's unitary tax, which respondents seek to challenge, is not now before this Court. Nor is the particular form of tax chosen by California common to all States. The process by which respondents have sought to challenge that tax, however, concerns all state and local governments because they depend on an uninterrupted flow of tax revenues.

The federal courts and Congress have recognized that the States, in order to fulfill their role in our federal system, must have both substantive flexibility in designing their tax structures and procedural freedom in fashioning their refund and remedy systems. The States, therefore, have been allowed to handle challenges to their taxes within their own administrative and judicial forums without having to face litigation in federal courts all over the country. It is imperative that the States' normal tax collection processes not be disrupted and delayed by external litigation.

The Seventh Circuit's decision undercuts the powerful and longstanding policy against federal court interference with the normal course of state tax collection. That policy, which was developed by this Court early in our Nation's history, has been embodied as a clear congressional mandate in the Tax Injunction Act, 28 U.S.C. § 1341. The decision below also ignores the basic principle that a corporation cannot avoid restrictions on its own ability to litigate in a particular forum—here im-

posed by the Tax Injunction Act—by having a shareholder institute suit on its behalf. Moreover, although this case directly concerns foreign parent corporations of domestic taxpayers, the Seventh Circuit's reasoning is broad enough to open a door through which domestic corporate parents could enter as well, nullifying, at least for multistate corporations, the strong policy against federal court intervention in state tax disputes.

Should the judgment below be affirmed, state and local governments would be subjected to delay in the collection of needed taxes, and to litigation of a multiplicity of suits challenging their tax systems in the federal courts—indeed, even in federal courts outside the taxing jurisdiction. The ability of *amici*'s members to meet their sovereign responsibilities and the needs of their citizens would be substantially impaired. *Amici* therefore submit this brief to assist the Court in its resolution of the case.<sup>1</sup>

### STATEMENT OF THE CASE AND INTRODUCTION

*Amici* adopt petitioners' statement of the case and would emphasize the following matters.

This case concerns the efforts of two foreign corporations to contest in a federal court outside California a California tax levied on their domestic subsidiaries doing business in that State. Respondents, Alcan Aluminium Ltd. (Alcan) and Imperial Chemical Industries PLC (Imperial), are foreign corporations doing business in California through wholly owned subsidiaries. The California Franchise Tax Board assessed the subsidiaries' tax using the California system of worldwide unitary income taxation.<sup>2</sup> That action is being challenged by

<sup>1</sup> The parties' letters of consent, pursuant to Rule 36 of the Rules of this Court, have been filed with the Clerk.

<sup>2</sup> California's unitary business/formula apportionment method of accounting to determine the tax liability for companies doing business in California is commonly called a unitary tax system. See

the two subsidiaries before state administrative officials and courts in California. J.A. 76 ¶ 29; J.A. 53-54 ¶ 29.<sup>3</sup> The parent corporations also brought suit to challenge the tax imposed on their subsidiaries. They filed suit in federal district court in Illinois to enjoin the Board from assessing or levying the tax on their California subsidiaries on the ground that the tax violated the Foreign Commerce Clause. The district court held that respondents lacked standing, and dismissed the suits, noting that their domestic subsidiaries, the taxpayers, could raise the constitutional claim in their state court suits. Pet. App. A-27.

The Seventh Circuit reversed. The court first noted that this Court, in cases involving domestic corporations, including those with foreign subsidiaries, has rejected claims that the unitary method of tax account-

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*Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 181-83 (1983); *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207, 221-23 (1980); *Mobil Oil Corp. v. Vermont Comm'r of Taxes*, 445 U.S. 425, 439-42 (1980). This Court has recently reaffirmed that California's "three-factor formula 'has become . . . something of a benchmark against which other apportionment formulas are judged.'" *Amerada Hess Corp. v. Director, New Jersey Div. of Taxation*, 109 S. Ct. 1617, 1621-22 (1989), quoting *Container Corp.*, 463 U.S. at 170.

California is not alone in employing this method of taxation. All 46 jurisdictions (States and the District of Columbia) that assess a tax on or measured by income use an apportionment formula, *Chart of State Taxes*, 1 State Tax Guide 665 (CCH) (1988); 24 follow the Uniform Division of Income for Tax Purposes Act, 7A U.L.A. 331 (West Supp. 1989); and 24 permit or require combined reporting (Multistate Corporate Tax Almanac 1-212 to 1-214 (Panel Pub. 1989)). Of course, the validity of California's tax system as applied to respondents' subsidiaries is not before the Court in this case.

<sup>3</sup> *Alcan Aluminum Corp. v. Franchise Tax Bd.*, No. 0196604 (L.A. Cty. Sup. Ct., filed Apr. 15, 1977); and *Alcan Aluminum Corp. v. Franchise Tax Bd.*, No. 322638 (Sacramento Cty. Sup. Ct., filed Aug. 17, 1984). Imperial's subsidiary is presently protesting the calculations of its tax in proceedings before the Franchise Tax Board.

ing violates the Commerce Clause or Foreign Commerce Clause "by unfairly overstating the income attributable to operations in the taxing state. See *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 180-84 (1983)." Pet. App. A-3 (citations omitted). The Court, however, has not determined the merits of the issue underlying this dispute over standing: whether the unitary tax violates the Foreign Commerce Clause when it is applied to domestic subsidiaries of foreign corporations. See *Container Corp.*, 463 U.S. at 189 n.26 and 195 n.32.

The court of appeals, acknowledging that shareholders like respondents cannot bring suit unless they demonstrate a direct and independent injury, found that the two grounds alleged by respondents were insufficient. The court rejected respondents' claims that requests for information from their subsidiaries, which the parent corporations might have to answer, imposed a direct burden on them as parent corporations. The court concluded that "the nominal incidence of compliance costs . . . would not, in itself, normally be determinative of 'direct' injury" because the costs can be viewed as increased overhead to the subsidiary's operations, thus affecting the parents merely "as shareholders in an enterprise faced with increased costs." Pet. App. A-14. The court also rejected the claim of double taxation, concluding that the tax could be viewed as "simply . . . added costs for the domestic subsidiary, experienced by the foreign parent as a decline in the after-tax profits of its California operations." *Id.* at A-14.

Instead, the court discerned an injury that respondents had not urged. The Seventh Circuit held that the California tax "diminishes the attractiveness of owning American subsidiaries in comparison with entering into contracts with independent companies as a means of engaging in foreign commerce." Pet. App. at A-14. This injury the court thought sufficient to give the parent corporations standing in federal court.<sup>4</sup> The court also con-

cluded that the Tax Injunction Act, 28 U.S.C. § 1341, was inapplicable because the non-taxpaying parent corporations could not bring suit in state court but must rely on the suits filed by their subsidiaries.

### SUMMARY OF ARGUMENT

This is a classic case of forum shopping by two foreign parent corporations of unitary businesses challenging in federal court a state tax levied on their domestic subsidiaries. The multinational parent corporations are seeking to evade the restrictions of the Tax Injunction Act, 28 U.S.C. § 1341, which precludes federal court intervention where there is "a plain, speedy and efficient" state remedy.

The Seventh Circuit's decision seriously erodes the non-intervention principle expressed in the Tax Injunction Act and, if not reversed, would force States to endure protracted litigation in distant forums, thereby crippling state revenue administration and collection. State courts, which after all are familiar not only with their own law but with federal constitutional mandates and the precepts of this Court, regularly decide challenges to state taxes, which can, if necessary, be reviewed by the Court.

The court below also misapplied the settled rule that a shareholder lacks standing to challenge a law affecting his corporation unless he can demonstrate direct injury

<sup>4</sup> Every other court of appeals that has examined whether foreign parents may sue in federal court to challenge taxes assessed against their domestic subsidiaries has ruled that the normal shareholder standing rules govern, and that the foreign parent corporations therefore lack standing. *EMI Ltd. v. Bennett*, 738 F.2d 994 (9th Cir.), cert. denied, 469 U.S. 1073 (1984); *Shell Petroleum, N.V. v. Graves*, 709 F.2d 593 (9th Cir.), cert. denied, 464 U.S. 1012 (1983); *Alcan Aluminum Ltd. v. Franchise Tax Board*, 558 F. Supp. 624 (S.D.N.Y.), aff'd mem., 742 F.2d 1430 (2d Cir. 1983), cert. denied, 464 U.S. 1041 (1984).

separate and distinct from that of the corporation. The court, while rejecting respondents' own allegations of direct harm, devised a rationale of independent injury that would virtually repeal the Tax Injunction Act for the benefit of non-resident owners of interstate businesses. This expansive theory of standing poses a grave danger for States because it could be applied to almost every tax contested by any out-of-state corporation.

Finally, the decision below disregards the strong national policy, based on principles of federalism, of allowing States to impose taxes and devise collection and review processes without federal intervention other than review by this Court. Apart from its specific errors, the decision is out of step with this Court's recent tax cases, which emphasize, often unanimously, the vitality and validity of federalism as living principle. See e.g., *Goldberg v. Sweet*, 109 S.Ct. 582 (1989) (state taxation of new forms of electronic commerce); *D.H. Holmes Co. v. McNamara*, 108 S.Ct. 1619 (1988) (fair and non-discriminatory state taxation not offensive to Commerce Clause, affirming principles of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977)). In any event, federal courts should not duplicate the work of state courts by prematurely supplying a federal forum but should require taxpayers to pursue state administrative and judicial remedies.

The failure of the court of appeals to respect state sovereignty simply encourages litigious corporate taxpayers to shop the country for a friendly forum, thereby diverting and dissipating scarce state resources from the collection of taxes to defending those taxes in distant federal courts.

## ARGUMENT

### I. THE TAX INJUNCTION ACT BARS AN ACTION IN FEDERAL COURT TO CHALLENGE A STATE TAX WHEN THE STATE PROVIDES A FORUM FOR SUCH A CHALLENGE.

The decision below permits respondents, foreign parent corporations of unitary businesses, to challenge in federal court a state tax that they do not pay; and, moreover, permits them to do so outside the taxing jurisdiction, in a district with little or no connection to the imposition or collection of the contested tax.<sup>5</sup> Respondents are forum shopping, seeking to evade the restriction imposed on federal court jurisdiction by the Tax Injunction Act, 28 U.S.C. § 1341.<sup>6</sup> That Act represents Congress's recognition of the havoc that could be

<sup>5</sup> See *State Tax Conference Focuses on Unitary, Mergers, and Compliance*, Tax Notes 1203, 1204 (June 5, 1989) (conference speaker suggests forum shopping for those dissatisfied with a State's application of a unitary tax).

<sup>6</sup> When Alcan filed this suit in Illinois, the Second Circuit had already ruled that Alcan did not have standing to maintain this kind of action there. *Alcan Aluminum Ltd. v. Franchise Tax Bd.*, 558 F. Supp. 624 (S.D.N.Y.), *aff'd mem.*, 742 F.2d 1430 (2d Cir. 1983), *cert. denied*, 464 U.S. 1041 (1984). In addition, its California subsidiary had one suit pending in California state courts and one about to be filed; these suits protested the subsidiaries' taxes for the years 1965-71 and 1972-74. See n.3, *supra*. In the district court below, the Franchise Tax Board argued that Alcan's suit was barred by collateral estoppel, but the court did not rule on this objection because it dismissed the case for want of standing. In addition, although the Board's Chicago office audited the 1976 through 1978 returns of Alcan's subsidiary, there is no indication in the record that the returns for 1965 through 1975 were audited by the Chicago office. J.A. 68 ¶ 16. See *Alcan Aluminum Ltd. v. Franchise Tax Bd.*, 558 F. Supp. 624 (S.D.N.Y. 1983).

Imperial brought suit in Illinois even though its subsidiary has never been audited by the Board's Chicago Office. It was audited only in New York and California (J.A. 43 ¶ 9), where suit was barred by the law of those circuits. See n.4, *supra*.

wrought on state tax systems by federal court suits, and prohibits such suits unless the state courts do not afford a sufficient remedy.<sup>7</sup>

The policy underlying the Tax Injunction Act is so strong and so firmly rooted in history that it hardly needs elaboration. It began with the doctrine of equitable restraint, which bars suits in equity "in any case where plain, adequate and complete remedy may be had at law." *Matthews v. Rodgers*, 284 U.S. 521, 525 (1932), quoting Section 16 of the Judiciary Act of 1789.<sup>8</sup> Equitable restraint carried "peculiar force in cases . . . brought to enjoin the collection of a state tax." *Rodgers*, 284 U.S. at 525. Federal injunctive relief was precluded because of the special importance of taxes to governments. See *Fair Assessment in Real Estate Ass'n v. McNary*, 454 U.S. 100, 107-09 (1981).

In 1937, Congress, concerned with what it saw as the threatened erosion of this policy by the federal courts, imposed restraint by statute. The Tax Injunction Act was designed to require challenges to state taxes to be litigated in state courts, and that is where they have been litigated.<sup>9</sup> As the court below acknowledged (Pet.

<sup>7</sup> Title 28 U.S.C. § 1341 provides:

The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State.

<sup>8</sup> In an early decision, *Dows v. City of Chicago*, 78 U.S. (11 Wall.) 108 (1871), the Court barred federal injunctive relief to a taxpayer because States rely on taxation to carry on government, and they must be assured a continuing source of revenue during litigation of the tax at issue.

<sup>9</sup> The Act was "first and foremost a vehicle to limit drastically federal district court jurisdiction to interfere with so important a local concern as the collection of taxes." *Rosewell v. LaSalle Nat'l Bank*, 450 U.S. 503, 522 (1981); see 81 Cong. Rec. 1415 (1937) (Statement of Sen. Bone); S. Rep. No. 1035, 75th Cong., 1st Sess. 2 (1937). See also *Tully v. Griffin, Inc.*, 429 U.S. 68, 73

App. A-18), "[t]he Act has been interpreted broadly in light of Congress' intent 'to prevent federal-court interference with the assessment and collection of state taxes" (citing *California v. Grace Brethren Church*, 457 U.S. 393, 411 (1982)), and this Court "has also adopted a lenient construction of the 'plain, speedy and efficient' proviso" (citing *Grace Brethren*, 457 U.S. at 412-13, and *Rosewell v. LaSalle National Bank*, 450 U.S. 503, 512-14 (1981)).

Time has borne out the wisdom of Congress's determination that state courts are the appropriate forum for resolving challenges, including constitutional challenges, to state taxes. State courts have regularly entertained, and not infrequently upheld, constitutional challenges to taxes imposed by their state legislatures.<sup>10</sup>

There is no question here concerning the adequacy of the remedy afforded by the California courts to California taxpayers, including respondents' domestic subsidiaries, to contest the constitutionality of the State's unitary tax. In fact, Alcan's California subsidiary has pending in the California courts two suits seeking tax refunds; and Imperial's California subsidiary is presently challenging its tax through the State's administrative process, which is, of course, subject to judicial review. Although respondents cannot directly invoke these state remedies—because they are not California taxpayers—

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(1976); *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293, 298-99 (1943).

<sup>10</sup> This Court has before it consolidated cases involving questions concerning refunds of state taxes found invalid by the state courts. *McKesson Corp. v. Florida Div. of Alcoholic Beverages & Tobacco*, No. 88-192; *American Trucking Ass'n v. Arkansas Hwy. & Transp. Dept.*, No. 88-325. See also, e.g., *Huie v. Private Truck Council, Inc.*, 466 N.E.2d 435 (Ind. 1984); *Burlington N. R.R. Co. v. Board of Supervisors*, 418 N.W.2d 72 (Iowa 1988); *LaRoque v. State*, 178 Mont. 315, 583 P.2d 1059 (1978).

they are clearly in a position to direct their wholly owned subsidiaries in the pursuit of relief in the State's tribunals. No reason appears why respondents should be free to pursue their indirect claims in a distant federal forum that is more to their liking.<sup>11</sup>

The court below gave insufficient weight to the strong policy against federal interference with state tax proceedings. If the decision is allowed to stand, it will seriously erode the non-intervention principle embodied in the Tax Injunction Act. The reasoning of the Seventh Circuit is not restricted to foreign parents of domestic corporate taxpayers; its logic would apply equally to domestic corporate parents. Large multistate and multinational corporations could use their vast economic power<sup>12</sup>

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<sup>11</sup> Although respondents may not proceed in federal court, they have several alternative forums to the state courts. They may attempt to persuade the California Legislature that wholly owned subsidiaries of foreign corporations should receive special tax treatment. They may seek the intervention of the executive and legislative branches of the federal government. Multinational corporations in fact persuaded the Secretary of the Treasury to set up a working group with States using unitary tax systems. In response to the corporations' objections, many of the States, including California, have modified their statutes. 1986 Cal. Stat., ch. 660; 1988 Cal. Stat., ch. 989; Cal. Rev. & Tax Code § 25110 *et seq.* (Deering 1988). Similarly, if respondents believe that the state courts are not competent to rule on the constitutional validity of their own States' tax systems, they may appeal to Congress to change the Tax Injunction Act to give them a preference. They may not, however, do an end run around Congress's previous decision, expressed in that Act, that they may not proceed in federal court.

<sup>12</sup> The economic strength of multinational corporations exceeds that of many States. For example, Imperial has 118,600 employees, and its annual sales exceed \$20.8 billion. Standard & Poor's 1365 (1989). Alcan has 63,000 employees and annual sales of \$6.9 billion. *Id.* at 69. Imperial's sales exceed the annual revenues of all but six States. U.S. Dep't of Commerce, Bureau of the Census, *State Government Finances in 1987*, Table 3 (Sept. 1988). Alcan's

to cripple state revenue collection by challenging state taxes in federal courts far removed from the taxing jurisdiction, as in this case. To permit the ruling below to stand would be to repeal the Tax Injunction Act for the benefit of nonresident owners of corporations that object to state tax formulas for interstate businesses.

## II. RESPONDENTS LACK STANDING IN FEDERAL COURT TO CHALLENGE A STATE TAX ON THEIR DOMESTIC SUBSIDIARIES.

In permitting this litigation to proceed, the court below not only gave insufficient weight to the Tax Injunction Act, it misapplied established principles of standing. The Seventh Circuit erred both in the standard it chose to measure standing and in concluding that respondents had suffered direct injury sufficient to confer standing on them.

The court began by acknowledging the applicability of "the well established rule that shareholders must ordinarily demonstrate a direct and independent injury to bring suit" (Pet. App. A-2), but considered this rule a prudential limitation on the court's exercise of jurisdiction rather than a constitutional limitation. *Id.* at A-5. The opinion then drew a distinction between cases involving issues "at the core" of the "prudential aspect of the standing question" (*id.* at A-10), such as "concerns about the limits on judicial power and the appropriateness of a particular plaintiff bringing a particular action" (*ibid.*), and cases that raise merely the "housekeeping concerns" (*id.* at A-11) of "avoid[ing] a multiplicity of suits and . . . conserv[ing] judicial resources." *Id.* at A-10-A-11. The court mistakenly concluded that this case fell into the second category, where the "underpinnings [of

sales are greater than the annual revenues of 32 States (*ibid.*), and it has more employees than half the States (U.S. Dep't of Commerce, Bureau of the Census, *Public Employment in 1986*, Table 7-(March 1988)).

the standing issue] are weakest." *Id.* at 17.<sup>13</sup> This conclusion is fundamentally at odds with the historic policy of Congress and the federal courts, discussed above, to respect the integrity of state tax structures and procedures. It also offends the basic principles that define the role of the States in our federalist system of government.

Even under the "weak" standard deemed appropriate by the court below, respondents have shown no direct injury to themselves, independent of injury to their subsidiary corporations, that could support their standing to challenge the California tax.<sup>14</sup> Indeed, the Seventh Circuit rejected the respondents' own assertions of independent injury: the alleged burden on them caused by the State's requests for information from the taxpayer subsidiaries about the unitary business, and the alleged double taxation. See Pet. App. A-14. The Second and Ninth Circuits had already rejected claims like the first (*EMI Ltd. v. Bennett*, 738 F.2d 994 (9th Cir.), *cert. denied*, 469 U.S. 1073 (1984); *Shell Petroleum, N.V. v. Graves*, 709 F.2d 593 (9th Cir.), *cert. denied*, 464 U.S. 1012 (1983); and *Alcan Aluminum Ltd. v. Franchise Tax Board*, 558 F.Supp. 624 (S.D.N.Y.), *aff'd mem.*, 742 F.2d 1430 (2d Cir. 1983), *cert. denied*, 464 U.S. 1041 (1984)), and the Ninth Circuit had also rejected claims like the second (*EMI*, 738 F.2d at 996; *Shell*, 709 F.2d at 595).

<sup>13</sup> The court's view that the standing issue was "weak" may explain its puzzling references to *Colorado River Water Conservation Dist. v. United States*, 424 U.S. 800 (1976), which dealt with abstention from the exercise of federal jurisdiction. *Colorado River* did not raise the question posed by this case: whether federal jurisdiction exists to entertain a challenge to a state tax by corporations that are not even subject to the tax.

<sup>14</sup> See *Valley Forge Christian College v. Americans United for Separation of Church and State*, 454 U.S. 464, 472 (1982); *Pittsburgh & W.Va. Ry. v. United States*, 281 U.S. 479, 486-87 (1930).

Instead, the court supplied its own rationale for standing based on "the relationship between the foreign parents and their domestic subsidiaries: the subsidiaries are owned as instrumentalities of the foreign commerce of their parents." Pet. App. A-15. According to the court, the effect of the unitary tax formula may be to make taxable in California a greater part of the subsidiaries' income than if the parent corporations had engaged in the same foreign commerce through contracts with unaffiliated companies; therefore, it has the "potential . . . to penalize foreign ownership of American assets." *Ibid.* The court concluded that respondents therefore are injured "by the distortion" of their "choices about the manner in which international trade is to be conducted." *Id.* at A-17.<sup>15</sup>

This theory of standing is plainly wrong. The court failed to recognize that whenever a corporation contemplates engaging in business within another State, it must weigh a wide variety of tax and other obligations and burdens, in deciding whether to transact its business by itself, through a subsidiary, or under contract with outside companies, no matter what forms of taxes the State has. Thus, the court's theory would allow almost every out-of-state corporation, engaged in either interstate or foreign commerce, to challenge almost every tax in federal court. This radical theory sweeps far too broadly and should be rejected.

<sup>15</sup> The court's theory of standing apparently was influenced by its view of the substantive claims raised by respondents. See Pet. App. A-17: "It is important that these injuries . . . have fueled a simmering trade controversy which has raised concerns about foreign retaliation and the country's ability to speak with one voice on matters of foreign commerce—concerns that are central to the purposes of the foreign commerce clause." Because this claim can certainly be raised in the California courts and then before this Court, there is no reason to disregard a congressional mandate and normal standing rules. To the contrary, the merits of a constitutional challenge are irrelevant to the determination whether standing exists. *Warth v. Seldin*, 422 U.S. 490, 500 (1975).

### III. THE RESPECT AND COMITY OWED TO STATE GOVERNMENTS UNDER BASIC PRINCIPLES OF FEDERALISM PRECLUDE FEDERAL COURT INTERVENTION IN STATE TAX SYSTEMS.

The decision below, in its misapplication of a specific congressional enactment and of general principles of standing, disregards the importance of allowing state tax laws to be implemented, and state tax collection and review processes to proceed, without federal intervention. It simply ignores the fundamental role of the States in our federal system.

This Court, in its decisions on the general dynamics of state-federal interaction, has repeatedly reaffirmed the basic blueprint of our Nation as a carefully balanced structure of national and state governments, each with a vital role to play. While recognizing the supremacy of the national government in a long list of essential federal functions, the Court has recognized that the Constitution prescribed a continuing role for the States, not only as experimental laboratories of democracy (*see New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting)), but as sovereign entities with day-to-day responsibility for the many needs of a civilized society. In the tax field in particular, the Court, after a period of division and dispute, has issued a series of recent unanimous decisions enunciating clear principles governing what had been earlier described as "the sovereign right of the United States as a whole to let the States tax as they please." *Container Corp.*, 463 U.S. at 194.

For example, in *D.H. Holmes Co. v. McNamara*, 108 S.Ct. 1619 (1988), the Court emerged from the "quagmire" of its earlier decisions. *See Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 329 (1977), citing *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959). *D.H. Holmes* unanimously reaffirmed the principle set forth in *Complete Auto Tran-*

*sit, Inc. v. Brady*, 430 U.S. 274 (1977), that so long as they adhered to general standards of fairness and non-discrimination, the States could adopt the taxing methods deemed best by their elected legislatures without offending the Commerce Clause. Just this year, in *Goldberg v. Sweet*, 109 S.Ct. 582 (1989), a unanimous Court made clear that this state prerogative was flexible enough to adapt tax measures to new electronic forms of commerce never envisioned by the Nation's founders but indispensable today.

The same respect for state taxing authority has marked the Court's disposition of challenges to state taxation of unitary businesses on preemption grounds. *Shell Oil Co. v. Iowa Dept. of Revenue*, 109 S.Ct. 278 (1988), unanimously held that Congress, when it barred taxation of income derived from the Outer Continental Shelf, did not bar inclusion of such income in the tax base used to compute a State's apportioned share of the income of a unitary business. Similarly, in *Amerada Hess Corp. v. Director, New Jersey Division of Taxation*, 109 S.Ct. 1617 (1989), the Court, without dissent, confirmed that a State could apply different rules for deduction of a federal tax than those in the Internal Revenue Code.<sup>16</sup>

In short, this Court has reinvigorated the essential notion of our constitutional structure that the States have broad leeway to levy their own taxes provided only that they do so fairly, without discrimination against out-of-state interests, and without encroaching on legitimate powers of the national government. Within their own sphere, the States are allowed to fulfill their governmental responsibilities without interference from the federal courts. These principles stem from historic comity and, in the tax field, are reinforced by statutory mandate.

<sup>16</sup> *Amerada Hess* also rejected claims that the New Jersey tax rules violated the Commerce Clause and the Due Process and Equal Protection Clauses. 109 S.Ct. at 1625.

See also *California v. Grace Brethren Church*, 457 U.S. 393, 411-13 (1982) (no declaratory judgment action against state taxes); *Fair Assessment*, 454 U.S. at 107-11 (no Section 1983 action against state taxes).

Accordingly, in a case like the present one, the overriding question is whether there is any need for a federal court to interject itself into the state tax review process at an early stage, before that process has had an opportunity to work. Virtually all state tax cases come to this Court from the state courts, which have proved themselves to be responsive to federal constitutional mandates. See p. 10 n. 10 *supra*. The Court itself has upheld and relied on the analysis of the state courts. See, e.g., *Amerada Hess*, 109 S.Ct. at 1622-24. The need for duplicative consideration of such cases in the lower federal courts has not been demonstrated. There is simply no reason to fear that important constitutional challenges to state taxes will either fail to receive serious treatment in the state courts or that the decisions will escape review. Those challenges may come before this Court from the state courts just as from the lower federal courts. Whatever the validity of the Seventh Circuit's concerns about the merits of respondents' challenge, there is no justification for bending all the procedural rules and doing the violence to deep-seated principles of federalism that would be required to allow this case to be heard in federal court.

In this case, especially, it is abundantly clear that the court of appeals failed to give due deference to the sovereignty of the States. The decision below, if upheld, would contradict the entire thrust of this Court's decisions concerning the proper state-federal dynamic, would directly infringe the historic right of the States to implement their own tax policies without intervention by the federal courts, and would seriously undermine the specific protections of the Tax Injunction Act. It is important for this Court to clarify once again that comity

and deference to the States in the discharge of their governmental responsibilities is not a mere matter of "house-keeping" for the federal courts, but one of the vital constitutional precepts upon which this Nation is built.

### CONCLUSION

For the foregoing reasons, the judgment below should be reversed.

Respectfully submitted,

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In The  
**Supreme Court of the United States**

October Term, 1988

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA; LEONARD WILSON, Individually and as District Manager, Chicago Office of the Franchise Tax Board of the State of California; and B.M. RARANG, Individually and as Auditor, Chicago Office of the Franchise Tax Board of the State of California,

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ON PETITION FOR CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS  
FOR THE SEVENTH CIRCUIT

BRIEF OF *AMICI CURIAE* IN SUPPORT OF  
THE PETITIONERS BY THE STATE OF IDAHO  
AND SEVERAL OTHER STATES

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## QUESTIONS PRESENTED

1. Whether a foreign company which is the sole stockholder of an American subsidiary has standing to challenge in federal court the accounting method by which the State of California determines the locally taxable income of that subsidiary.

2. Whether, assuming that requisite standing exists in such an instance, a federal action for injunctive and declaratory relief is nevertheless barred by the Tax Injunction Act (28 U.S.C. § 1341) or the principle of comity which underlies the Act.

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## INTEREST OF AMICI CURIAE

This brief in support of California is submitted on behalf of Idaho, Alabama, Arizona, Arkansas, Colorado, District of Columbia, Florida, Georgia, Hawaii, Illinois, Indiana, Iowa, Kansas, Maine, Maryland, Massachusetts, Minnesota, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, New York, North Dakota, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin and Wyoming pursuant to Supreme Court Rule 36.4.

Respondents, by their lawsuits, seek to have the federal courts rule on the validity of taxes which California has assessed to respondents' wholly owned subsidiaries, which are California taxpayers. ICI Americas, hereinafter Americas, is a wholly owned third tier subsidiary of Imperial and was a California taxpayer for the years 1972 through 1981 (JA 41, ¶6). Alcan Aluminum Corporation, hereinafter AlcanCorp, is a third tier wholly-owned subsidiary of Alcan (JA 65, ¶7) and along with several other wholly-owned entities was a California taxpayer during the years 1965 through 1978 (JA 65, ¶7). Collectively, Americas and AlcanCorp are hereinafter referred to as the taxpayer/subsidiaries. The nature of California's tax is irrelevant to amici and is irrelevant to the questions presented by this case to the Court.<sup>1</sup> What is relevant are

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<sup>1</sup> The issue respondents seek to adjudicate involves California's application of the unitary business principle. How California applies the unitary business principle has little relevance to most of amici, some of which do not even assert a tax on or measured by income, and some of which apply the unitary business principle using procedures which differ from California's.

the questions of who may bring an action to question the application of a state tax and in what courts that action may be brought. Amici share a common belief that the appropriate party to litigate the validity of their taxes is the taxpayer and that the appropriate forums are their State courts.

If the Seventh Circuit's decision is upheld by this Court, the consequences are likely to include a multiplicity of suits brought by sole or majority shareholders; the wholesale use of federal courts to rule on state tax questions; and the need for the several states to appear and defend lawsuits outside of their individual boundaries. Such results will at least temporarily deprive the states of their lifeblood and will require the states to expend significant additional resources to collect their just due. The Seventh Circuit's decision violates the principles of comity and federalism upon which our government is based and provides a blueprint for avoiding the will of Congress in this area as expressed in the Tax Injunction Act (28 U.S.C. § 1341).

For all of the above reasons the interests of amici are direct, real and vital. The significance of these interests is underscored by the number of participating states.

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### STATEMENT OF FACTS

Amici adopt the Statement of the Case set forth in Petitioner's Brief on the Merits.

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### SUMMARY OF ARGUMENT

This case can be phrased in terms of three separate questions: standing, construction of the Tax Injunction

Act, and comity. But these three issues are so interrelated philosophically and historically that the arguments and authorities overlap. See e.g., *Fair Assessment in Real Estate v. McNary*, 454 U.S. 100 (1981). Amici attempt to address each of the issues separately in the body of this brief, but invariably consideration and resolution of any single issue necessitates consideration of the other issues.

The basic principle underlying each of the questions presented herein is that, in the first instance, the sovereign should set the ground rules under which it will consider a challenge to the validity of the taxes it wishes to assert. This principle allows the sovereign to require that actions be brought only by taxpayers and that such actions be brought in its own courts. The federal government follows this principle with respect to its own taxes, e.g. 26 U.S.C. § 7421(a). The states follow it. Implementation of this principle within the framework of our federal system of government, which recognizes the sovereignties of the states, has led the federal government to refrain from considering initial challenges to state taxes. This Court's review of state court decisions provides necessary taxpayer safeguards, while recognizing each state's interest in being the primary adjudicator of its own tax laws. Various branches of the federal government have considered taxpayer efforts to avoid the application of this principle and have rejected them. As examples, Congress enacted the Tax Injunction Act (28 U.S.C. § 1341) to thwart abuses of diversity jurisdiction and this Court in *California v. Grace Brethren Church*, 457 U.S. 393 (1982), recognized that the Tax Injunction Act's prohibitions should cover actions for declaratory relief.

This case is yet another effort by the corporate community to contest a state tax in federal court. Once again, this effort should be rejected by the Court. Respondents'

waving of foreign flags and pleading of their separate corporate status from the taxpayers do not change the fundamental question presented. Such tactics represent nothing more than variations upon the theme, a newly dressed version of an ancient, rejected strategy to litigate state taxes in federal courts. The Court should rebuff these efforts and should, consistent with its prior holdings and the directives of Congress, reverse the Seventh Circuit's decision so these cases may properly proceed in state courts in actions brought by the taxpayers.

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## ARGUMENT

### I. ESTABLISHED RULES ON STANDING DO NOT PERMIT A STOCKHOLDER TO CHALLENGE STATE TAXES LEVIED AGAINST THE CORPORATION

#### A. The Principles of Standing

The essence of the standing inquiry as articulated by this Court "is whether the litigant is entitled to have the court decide the merits of the dispute or of particular issues." *Warth v. Seldin*, 422 U.S. 490, 498 (1975). In particular, "The requirement of standing 'focuses on the party seeking to get his complaint before a federal court and not on the issues he wishes to have adjudicated.'" *Valley Forge College v. Americans United*, 454 U.S. 464 at 484 (1982), quoting *Flast v. Cohen*, 392 U.S. 83 at 99 (1968). (Emphasis added.) "[S]tanding is not measured by the intensity of the litigant's interest or the fervor of his advocacy." *Valley Forge*, *supra* at 486. The Court has "rejected the argument that standing should be recognized because 'the adverse parties sharply conflicted in their interests and views . . .'" (*Ibid.*, n. 21, quoting

*Schlesinger v. Reservists Committee to Stop the War*, 418 U.S. 166, 225 (1974).)

The question of standing has particular significance in cases involving state taxes. The sensitive nature of the relationship between the state and federal governments and the importance of tax collection to governments generally have caused the federal courts to exercise restraint when deciding cases that affect the state tax structures. *Fair Assessment in Real Estate v. McNary*, 454 U.S. 100 (1981). Congress has also recognized the principle of noninterference and has strengthened it when the federal courts have wavered. See discussion of Tax Injunction Act, *infra*, at 13-20.

There are two components to standing, the constitutional or Article III requirements and a set of prudential principles. Each component has three major parts. Under Article III, "[A] plaintiff must [1] allege personal injury [2] fairly traceable to the defendant's allegedly unlawful conduct and [3] likely to be redressed by the requested relief." *Allen v. Wright*, 468 U.S. 737 at 751 (1984), citing *Valley Forge College v. Americans United*, 454 U.S. 464 at 472 (1982). The prudential principles consist of " . . . [1] the general prohibition on a litigant's raising another person's legal rights, [2] the rule barring adjudication of generalized grievances more appropriately addressed in the representative branches and [3] the requirement that a plaintiff's complaint fall within the zone of interests protected by the law invoked." *Id.*

The concepts incorporated in each of the components and their parts are not susceptible of precise definition, *Allen v. Wright*, *supra* at 751-52, and they obviously overlap. (For example, the Art. III requirement that a plaintiff

must allege a personal injury and the prudential prohibition on a litigant raising another person's legal rights are similar if not identical.)

The absence of precise definitions, however, as this Court's extensive body of case law on standing illustrates, see generally *Valley Forge*, supra, at 471-476, 70 L Ed 2d 700, 102 S Ct 752, hardly leaves courts at sea in applying the law of standing. Like most legal notions, the standing concepts have gained considerable definition from developing case law. In many cases the standing question can be answered chiefly by comparing the allegations of the particular complaint to those made in prior standing cases. (*Id.*)

**B. The Injuries Alleged Are Those of the Taxpayer/Subsidiaries, and Therefore Do Not Support Respondents' Claim to Standing**

The first requirement of Article III standing is that plaintiff must allege personal injury. Prudential limitations on standing also generally preclude a party from litigating the legal rights of another. Under either test, respondents have no standing with respect to the putative administrative and financial burdens or multiple taxation because such burdens are borne directly by their subsidiaries.

The two injuries which are the gravamen of the complaints are multiple taxation (JA 9-10 ¶16, JA 20 ¶11) and administrative financial burdens. (JA 9 ¶14, JA 19-20 ¶10.)<sup>2</sup> To the extent these injuries exist, they clearly are

<sup>2</sup> Respondents have also alleged (JA 10 ¶17, JA 19 ¶9) that California's utilization of "worldwide unitary income" as a

(Continued on following page)

borne directly by the *taxpayer/subsidiaries*. It is stipulated that both the proposed assessments and all correspondence requesting information were directed to the taxpayer/subsidiaries. (JA 53 ¶27, JA 99 ¶52.) It is self-evident that any injuries are borne directly by the taxpayer/subsidiaries.

This is a case where the question of standing can be answered by reference to a rule previously developed by the courts. See *Allen v. Wright*, *id.*, quoted *supra* at 6. Respondents' injuries, to the extent they may exist, are merely the indirect result of actions taken against the corporations in which they have an interest. In such an instance, a shareholder is not entitled to bring an individual action against the alleged wrongdoer. Any injuries to the shareholder are indirect, not direct, and therefore the shareholder does not have standing. *Pittsburgh & W.Va.Ry. Co. v. United States*, 281 U.S. 479 at 487-489 (1929); *Hawes v. Oakland*, 104 U.S. 450 (1881).

Consistent application of the shareholder standing rule, and narrow construction of exceptions to the rule, have been a tradition of the federal courts. In *Hawes v. City of Oakland*, *id.*, this Court, in rejecting a shareholder's

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base for taxation imposes a tax upon the parent companies and their non-United States subsidiaries. However, "income that is included in the preapportioned tax base is not, by virtue of that inclusion, taxed by the State." *Shell Oil Company v. Iowa Department of Revenue*, 488 U.S. \_\_\_\_ (1988). Furthermore, it is stipulated in both cases that the only entities taxed by California are respondents' United States subsidiaries doing business in California and that no tax has been assessed by California against respondents or their non-United States subsidiaries. (JA 53 ¶27 and JA 99 ¶52.)

claim of standing, found that the claim was raised by the shareholder largely to obtain access to the federal courts in New York and to avoid the state courts of California and not because he had injury independent of the corporation. The case was dismissed despite the fact the corporation had not instituted suit itself. The court in its decision noted the existence of the potential for collusion to avoid jurisdiction of the state courts.

The parallels to the present cases seem obvious but were ignored by the Seventh Circuit. Shareholders will not ignore the Seventh Circuit's decision, however. If this Court adopts the approach of the Seventh Circuit, it is not hard to imagine that virtually all corporate state tax disputes might be litigated in federal court. For those taxpayers who do not currently have a parent corporation to maintain the action, the simple expediency of a reorganization will remedy the "defect." The question of standing is of more substance than the Seventh Circuit accords it.

### **C. Burdening a Parent-Company's Decision-Making is Not a Cognizable Injury for Standing Purposes**

The Seventh Circuit recognizes that allegations of multiple taxation and compliance burdens relate to "injuries" sustained by the taxpayer/subsidiaries and that under traditional analysis these allegations do not establish injury to respondents sufficient to confer standing on them. (Pet. App. A-13.) The Seventh Circuit, however, says the focus of the standing inquiry cannot be limited to the relationship between parent and subsidiary but must be expanded in recognition that the subsidiary is an

instrumentality of foreign commerce. (Pet. App. A-15.)<sup>3</sup> Under this expansive view, a direct injury is found because respondents' decision as to how to conduct its foreign commerce was "burdened," "distorted," and "penalized." (Pet. App. A-15-16.) A particular mode of foreign participation was "disfavored." (*Id.*)

Even if the Seventh Circuit's characterizations are correct, however, it does not follow that the "burden" on decision-making is an independent, cognizable injury to respondents. To help determine whether the parent corporations are directly injured, one can look to the cause of the purported injury. Here the cause of the purported injury to the parent companies is the higher tax assessed against AlcanCorp and Americas and the taxpayer/subsidiaries' cost of compliance. Respondents are injured only because their subsidiaries bear greater costs. Respondent's injuries are therefore not direct and do not create standing.

The forced nature of the Seventh Circuit's finding is revealed by further consideration of the alleged injury, a burden on a decision. It is clear that the exercise of choices, the picking of one alternative over others, necessarily contemplates the weighing of the costs and benefits of each. The fact that one choice or alternative may be

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<sup>3</sup> Amici believe it is unlikely that the Seventh Circuit's holding would be restricted solely to foreign commerce. The reasoning of the Court of Appeal appears to apply equally to interstate commerce.

more attractive than others, however, does not cause a cognizable injury. Choosing between alternatives is what businesses do; they make business choices. Under the Seventh Circuit's analysis, however, the State must act to ensure absolute neutrality between alternatives or it has caused an injury and created a cause of action.

The Seventh Circuit correctly points out foreign companies can choose the means by which they conduct commerce in California. It posits two alternatives, through arm's-length transactions with unaffiliated entities and through subsidiaries. (Pet. App. A-15.)<sup>4</sup> It finds that the income *attributable to California* in the latter situation (use of subsidiaries) will be potentially higher than in the former (third party).

The fact that the costs may differ depending upon the choice does not establish injury any more than does the fact that the benefits may differ. Any cost, tax, environmental restriction, registration requirement, or labor law can "burden" the decision as to how to participate in a state. Any business faces the same choice. This does not confer standing on respondents or any shareholder, however. Once respondents determine they wish to participate in a state's economy, they are subject to the "burdens" of that participation. If they participate

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<sup>4</sup> These are not the only alternatives. For example, respondents could participate directly in California themselves. However, analytically the results are the same because they contrast third party participation with participation by the enterprise.

directly, they may contest the "burdens" directly. If they participate through a subsidiary, it is the subsidiary to which the "burdens" apply and which must challenge the "burdens." If they choose to deal only with unrelated third parties, no "burdens" apply but benefits are foregone. This is their choice and one which they must weigh. It does not mean, however, that a state must accord them special treatment and allow them to participate in its economy free of any and all "burdens."

Corporate businesses engaging in interstate or foreign commerce are always confronted with decisions as to how to conduct that commerce. These decisions are made by weighing burdens and benefits. The Seventh Circuit's analysis will create federal court standing to challenge any state action as long as a stockholder/subsidiary relationship is created. The Seventh Circuit's decision has the potential to eliminate standing considerations for all incorporated businesses and should not be allowed to stand.

#### **D. The Seventh Circuit's Decision Improperly Focuses On The State Tax Issue Sought to be Litigated**

The Seventh Circuit states, "It is important that these injuries, which FTB would have us label as indirect . . . , have fueled a simmering trade controversy . . . ." (Pet. App. A-17.) With respect to that controversy and with respect to comity the Seventh Circuit stated:

We hold that comity and federalism, weighty as these concerns are where federal courts pass on the constitutionality of state tax legislation, cannot justify

withholding federal jurisdiction from a party with no cause of action in state court to redress its own direct and independent injury. This is especially true where important, and apparently pressing, considerations of international comity as well as comity within our own federal system are at stake. Pet. App. at A-19.

The Seventh Circuit has focused upon the importance of the *issue* and not upon the appropriateness of the *party*. This focus is further demonstrated by its assertion that environmental or safety regulations are distinguishable because they affect foreign and domestically owned businesses equally. (Pet. App. A-14.) Environmental and safety regulations directly affect the entity they are asserted against. They affect the owner of the entity indirectly. The owner would no more have standing to complain of the effect of environmental or safety regulations regardless of their application (differential treatment for foreign and domestically owned entities) than respondents have standing to complain of taxes asserted against their subsidiaries.

The Seventh Circuit appears to take the approach that "the business of the federal courts is correcting constitutional errors, and that 'cases and controversies' are at best merely convenient vehicles for doing so and at worst nuisances that may be dispensed with when they become obstacles to that transcendent endeavor." *Valley Forge College v. Americans United*, 454 U.S. 464 at 489 (1982). The Supreme Court *rejected* this philosophical approach in the cited case.

## II. THE TAX INJUNCTION ACT BARS A STOCKHOLDER SUIT WHERE THE CORPORATION ITSELF HAS AN ADEQUATE STATE REMEDY

### A. Background

The federal government, in recognition of the importance of collecting its own revenues, adopted the Anti-Injunction Act, now 26 U.S.C. § 7421(a), in 1867. Virtually every State has a counterpart in its individual codes. Both the state and federal acts require the validity of taxes to be contested by specific parties and via specific limited avenues. Typically the tax may only be contested by a taxpayer through a suit for refund after payment, and in some cases in an appeal from some type of notice of deficiency. Generally, neither federal nor state governments allow the validity of their taxes to be adjudicated through an equitable proceeding seeking injunctive or declaratory relief.

States, however, can only limit the remedies which are available in their own courts. They cannot affect the remedies available in the courts of other jurisdictions. Actions brought in the courts of other jurisdictions have almost uniformly been dismissed on the principles of comity. These principles have been honored not just by the states, but they have also been recognized and followed by the federal courts. *Matthews v. Rodgers*, 284 U.S. 521 (1932); *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293 (1943); *Fair Assessment in Real Estate v. McNary*, 454 U.S. 100 (1981).

At one point, corporate taxpayers pleading diversity jurisdiction found the federal courts receptive to complaints about state taxes. In response, the Congress, in

recognition of the needs of state and local governments to have access to revenues, passed the Tax Injunction Act, now 28 U.S.C. § 1341, in 1937.

The Tax Injunction Act provides:

The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State.

The Tax Injunction Act is effectively a complement to the Anti-Injunction Act which is necessitated by our federal system of dual sovereignty. Its language generally parallels the Anti-Injunction Act. The Tax Injunction Act specifically requires that a state must provide a "plain, speedy and efficient remedy" for the adjudication of the validity of its tax. It is uncontested that California provides such a remedy. Respondents' sole basis of complaint is that the remedy lies with their wholly owned subsidiaries rather than in their own hands.

The purpose of the bill as explained by its author, Senator Bone, was "to take away the jurisdiction of Federal District courts to enjoin, suspend or restrain the assessment or collection of any tax imposed by or pursuant to the laws of any State." 81 Cong. Rec. 1415 (1937). The need for the legislation arose from "The existing practice of the Federal courts to entertain tax-injunction suits [which] make it possible for foreign corporations to withhold from a state and its governmental subdivisions taxes in such vast amounts and for such long periods as to disrupt State and county finances . . . " *Id.* at 416.

The Senate Committee on the Judiciary described the problem as follows:

The existing practice of the Federal courts in entertaining tax-injunction suits against State officers makes it possible for foreign corporations doing business in such States to withhold from them and their governmental subdivisions, taxes in such vast amounts and for such long periods of time as to seriously disrupt State and county finances. The pressing needs of these States for this tax money is so great that in many instances they have been compelled to compromise these suits, as a result of which substantial portions of the tax have been lost to the States without a judicial examination into the real merits of the controversy. Sen.Rep.No. 1035, 75th Cong., 1st Sess., p. 2 (1937).

Congress enacted the Tax Injunction Act in response to the corporate legal ploy of pleading diversity jurisdiction to obtain access to federal courts. As this Court has noted, "Congress worried not so much about the form of relief available in the federal courts as about divesting the federal courts of jurisdiction to interfere with state tax administration." *California v. Grace Brethren Church*, 457 U.S. 393, 409, n. 22 (1982).

The tenacity of the American taxpayer constantly threatens to drain the Nation of a life-sustaining infusion of revenues. See *Gorovitz, Federal Tax Injunctions and the Standard Nut Cases*, 10 *Taxes* 446, 446 (1932). Taxpayer tenacity applies to state taxes as well as federal taxes. In this case respondents seek to employ another classic legal strategy, use of the corporate form, to achieve the same result. Respondents' taxpayer/subsidiaries cannot bring an action in federal courts because

California provides them with a "plain, speedy and efficient remedy" as required by the Tax Injunction Act. Respondents seek to do what their taxpayer/subsidiaries cannot, sue in federal court. They argue the Tax Injunction Act does not apply to them because *they* have no remedy in California's courts. Respondents strategy must be recognized for what it is, a ploy. Some might argue an artful ploy, but nonetheless a ploy. If respondents' strategy is successful, the Court will have opened the floodgates for federal court suits by virtually every multijurisdictional business operating within the United States.

**B. The Tax Injunction Act by its Terms Bars Respondents Because Here The State Provides a "Plain, Speedy and Efficient Remedy"**

This Court has had occasion to review the reach of the Tax Injunction Act on several occasions, but has not had occasion to rule on the question of whether the requirements of the Tax Injunction Act are satisfied by having the right to a "plain, speedy and efficient remedy" in someone's hands other than those of the litigant. The Court, however, has had occasion to consider this question with respect to the Anti-Injunction Act. Given the close relationship between the purposes of the Anti-Injunction Act and the Tax Injunction Act and the similarity of their terms, this Court's teachings in *South Carolina v. Regan*, 465 U.S. 367 (1984), have application in this case and lead to a construction of the Tax Injunction Act barring these actions.

The Tax Injunction Act was conceived as an answer to a corporate practice of using diversity jurisdiction to avoid adjudication of the validity of a state tax in the courts of the taxing states. Justice O'Connor, in her concurring opinion in *Regan*, shows an acute awareness of the potential ingenuity of taxpayer efforts to avoid or impede the collection of taxes when she points to the possible collusive use of nontaxpaying association of taxpayers and nontaxpayer organizations to avoid the prohibition of the anti-injunction policy of the federal prohibition. *South Carolina v. Regan*, *supra* at 386. This case presents the very strategy Justice O'Connor warned of in only slightly different clothing. Instead of an association of taxpayers, we have the corporate shareholder of the taxpayer/subsidiary bringing the action. Instead of federal taxes we have state taxes. The names may differ, but the strategy is the same.

The majority in *Regan* responded to Justice O'Connor's concern as follows:

Justice O'Connor suggests that our holding today will enable taxpayers to evade the Anti-Injunction Act by forming organizations to litigate their tax claims. Post, at 386, 394, 79 L Ed 2d, at 387, 392. We disagree. Because taxpayers have alternative remedies, it would elevate form over substance to treat such organizations as if they did not possess alternative remedies. Accordingly, such organizations could not successfully argue that the Act does not apply because they are without alternative remedies. *Id.* at 381, n. 19.

If an organization has an alternative remedy available to it through a taxpayer/member, then a sole shareholder surely has a remedy available to it through a

wholly-owned taxpayer/subsidiary.<sup>5</sup> To hold otherwise would elevate form over substance.<sup>6</sup>

Construction of the Tax Injunction Act to prohibit suits by shareholders to litigate the tax obligations of the underlying corporate taxpayers is consistent with congressional intent. In passing the Tax Injunction Act, Congress sought to deny an advantage to corporate taxpayers with regard to access to the federal courts. Specifically, Congress acted to prevent the place of incorporation alone from giving rise to federal jurisdiction to hear a cause of action with respect to state taxes. Construction of the Tax Injunction Act to allow a shareholder access to

<sup>5</sup> It should be noted that Counsel of Record for respondents in these cases are employees of AlcanCorp and Americas, respectively.

<sup>6</sup> Alternatively, this Court should consider whether Justice O'Connor's literal approach to construction of the Anti-Injunction Act should be applied to the Tax Injunction Act in order to carry out the intent of Congress. While the majority in *South Carolina v. Regan*, *supra*, did not adopt a literal approach as to the Anti-Injunction Act regarding federal taxes, such an approach would be fully appropriate here. In order to "be faithful to the congressional intent 'to limit drastically' federal-court interference with state tax systems," this Court has recognized that it "must construe narrowly the 'plain, speedy and efficient' exception to the Tax Injunction Act." *California v. Grace Brethren Church*, *supra*, at 413. That exception to the Tax Injunction Act does not state that anyone other than the taxpayer must be accorded a "plain, speedy and efficient remedy." Furthermore, it is clear that California does provide such a remedy to taxpayers. See *id.*, at 413-417. Since California's remedy meets the standard set by the terms of the Tax Injunction Act, a narrow, literal construction of that standard would bar the federal courts from entertaining nontaxpayer suits which attempt to prevent collection of the California tax.

the federal court which the corporate taxpayer does not have will give rise to wholesale avoidance of the prohibition of the Act and frustrate clear congressional intent. The creation of a parent/subsidiary relationship should no more give rise to federal jurisdiction than should the place of incorporation. This is the only construction consistent with Congress' intent in enacting the statute. As the Court has stated, "In order to . . . be faithful to the congressional intent 'to limit drastically' federal-court interference with state tax systems, we must construe narrowly the 'plain, speedy and efficient' exception to the Tax Injunction Act." *California v. Grace Brethren Church*, 457 U.S. 393, 413 (1982).

This Court stated in *Grace Brethren*, ". . . we do not believe that Congress intended federal injunction and declaratory judgments to disrupt state tax administration when state refund procedures are available." *Id.* at 417. Disruption occurs just as readily when an action is brought by a shareholder of a taxpayer as when it is brought by the taxpayer. In either event, the Tax Injunction Act should bar federal court interference.

In *Grace Brethren* this Court construed the Tax Injunction Act to bar actions for declaratory relief even though it was not specifically mentioned in the statute. The Court stated: "[I]n enacting the Tax Injunction Act, Congress considered primarily injunctions against state officials because that form of anticipatory relief was the principal weapon used by businesses to delay or avoid paying state taxes" *Id.* at 409, n. 22. Similarly, until recently taxpayer actions were the vehicle for adjudicating the validity of state laws. Now a new strategy has arisen, shareholder suits. But just as in the case of suits for declaratory relief,

the result of allowing such suits would be the same, the circumventing of state courts. This result is inconsistent with the purpose of the Tax Injunction Act and should not be allowed by the Court.

### C. Summary

If the Tax Injunction Act is construed to allow respondents to maintain this action, the consequences are obvious. Any state corporate tax matter can be adjudicated in the federal courts merely by establishing a parent/subsidiary relationship. The Tax Injunction Act was enacted to prevent circumvention of the state courts. The means of circumvention are irrelevant. A parent/subsidiary relationship is no more meaningful a basis of establishing jurisdiction in a state tax case than is diversity.

### III. THE PRINCIPLES OF COMITY BAR THIS ACTION

In *Younger v. Harris*, 401 U.S. 37, 44-45 (1971), this Court stated:

the notion of "comity," that is, a proper respect for state functions, a recognition of the fact that the entire country is made up of a Union of separate state governments, and a continuance of the belief that the National Government will fare best if the States and their institutions are left free to perform their separate functions in separate ways. This, perhaps for lack of a better and clearer way to describe it, is referred to by many as 'Our Federalism,' and one familiar with the profound debates that ushered our

Federal Constitution into existence is bound to respect those who remain loyal to the ideals and dreams of 'Our Federalism.' The concept does not mean blind deference to 'States' Rights' any more than it means centralization of control over every important issue in our National Government and its courts. The Framers rejected both these courses. What the concept does represent is a system in which there is sensitivity to the legitimate interests of both State and National Governments, and in which the National Government, anxious though it may be to vindicate and protect federal rights and federal interests, always endeavors to do so in ways that will not unduly interfere with the legitimate activities of the States. It should never be forgotten that this slogan, 'Our Federalism,' born in the early struggling days of our Union of States, occupies a highly important place in our Nation's history and its future.

This Court has long recognized that the principles of comity apply with particular force in the area of federal court adjudication of the constitutionality of state taxes. *Matthews v. Rodgers*, 284 U.S. 521 (1932); *Singer Sewing Machine Co. v. Benedict*, 229 U.S. 481 (1913); *Boise Artesian Water Co. v. Boise City*, 213 U.S. 276 (1909). Partly in response to the same comity concerns expressed in federal cases and in part to further clear the federal courts, Congress enacted the Tax Injunction Act. *Fair Assessment in Real Estate v. McNary*, 454 U.S. 100 (1981). The action of Congress, however, has not robbed the principles of comity of any of their vitality in the area of state taxation. *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293 (1943); *Fair Assessment in Real Estate v. McNary*, 454 U.S. 100 (1981).

The principles of comity support federal court abstention from resolving the issues presented by respondents because their wholly-owned subsidiaries have a full and adequate remedy in the courts of California. If our federal system of government is to continue to function properly, this Court should not allow the federal court system to be the forum for resolving all state tax issues. That surely would be the result of permitting respondents to proceed in this case, since the rationale of the Seventh Circuit would apply to companies engaged in interstate as well as foreign commerce.

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### CONCLUSION

In general, taxpayers are only allowed to contest their federal taxes after they have paid them. Furthermore, shareholders of a corporation are not permitted to contest federal taxes assessed against the corporation. The States follow the same rules with respect to their own taxes.

Respondents seek a different result by bringing this action to contest state taxes assessed against subsidiaries in federal courts. This action is brought in spite of the fact that the taxpayer/subsidiary can bring, and in the case of AlcanCorp has brought, an action in state court and in spite of the Tax Injunction Act. Respondents' efforts should be rejected. To permit respondents to employ the artifice of separate incorporation to avoid a congressional prohibition, the principles of comity, and the doctrine of

standing is to pervert our federal system. This Court should reverse the holding of the Seventh Circuit.

DATED: June 8, 1989

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In The

**Supreme Court of the United States**

**October Term, 1988**

**FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA; LEONARD WILSON, individually and as District Manager, Chicago Office of the Franchise Tax Board of the State of California; and B. M. RARANG, individually and as Auditor, Chicago Office of the Franchise Tax Board of the State of California,**

*Petitioners,*

**v.**

**ALCAN ALUMINIUM LIMITED and  
IMPERIAL CHEMICAL INDUSTRIES PLC,**

*Respondents.*

**On Writ Of Certiorari To The United States  
Court Of Appeals For The Seventh Circuit**

**BRIEF OF THE MULTISTATE TAX COMMISSION,  
AS AMICUS CURIAE,  
IN SUPPORT OF PETITIONERS**

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## QUESTIONS PRESENTED

1. Whether a foreign company which is the sole stockholder of an American subsidiary has standing to challenge in federal court the accounting method by which the State of California determines the locally taxable income of that subsidiary;

2. Whether, assuming that requisite standing exists in such an instance, a federal action for injunctive and declaratory relief is nevertheless barred by the Tax Injunction Act (28 U.S.C. § 1341) or the principle of comity which underlies the Act.

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Petitioners,

v.

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Respondents.

On Writ Of Certiorari To The United States  
Court Of Appeals For The Seventh Circuit

BRIEF OF THE MULTISTATE TAX COMMISSION,  
AS AMICUS CURIAE,  
IN SUPPORT OF PETITIONERS

## INTEREST OF AMICUS CURIAE

The Multistate Tax Commission is the administrative arm of the Multistate Tax Compact (the "Compact"). The Compact has been agreed to by 18 member states and the

District of Columbia and by 10 states as associate members. Its purposes as stated in the Compact are to facilitate proper determination of state and local tax liability of multistate taxpayers, to promote uniformity or compatibility of tax systems, to facilitate taxpayer convenience and compliance, and to avoid duplicative taxation. The validity of the Compact was recognized by the Court in *U.S. Steel v. Multistate Tax Commission*, 434 U.S. 452 (1978).

To further the purposes of the Compact, the Multistate Tax Commission conducts joint audits for its members. The Commission maintains audit offices in New York, Chicago and Houston, a headquarter's office in Washington, D.C., and a branch legal office in California.

The Seventh Circuit's decision has the potential to upset what the Multistate Tax Commission had understood was settled doctrine – federal constitutional challenges of state taxation must in the first instance be made in state forums which permit a full and fair consideration of the federal rights sought to be preserved. By establishing an exception for state tax challenges brought by a shareholder of a corporation subject to state tax, the Seventh Circuit has raised the real possibility that parties indirectly and derivatively affected by state taxation will fashion an independent theory of attack which could be heard by the federal courts. In effect, the Seventh Circuit's decision, if allowed to stand, permits shareholders who are at best indirectly and derivatively affected by the state taxation of their corporations to seek a remedy which would not otherwise be available to the taxpayer corporation itself.

While this case involves a challenge based upon the Foreign Commerce Clause, the Multistate Tax Commission believes the principles created by the Seventh Circuit will be used in other multijurisdictional contexts by shareholders of corporations. For example, the Seventh Circuit's decision may well permit any unsettled question involving unitary taxation, whether applied on a worldwide or domestic basis, to be fashioned into an alleged injury at the shareholder level which is justiciable in the federal courts. Likewise, the claimed injuries here used to justify federal court intervention in state tax administration appear flexible enough to be repeated in the context of state taxation not involving foreign commerce. Thus, a shareholder whose corporation is involved in interstate commerce may be equally able to complain about administrative burdens resulting from compliance with state taxation principles and about discrimination against the form of business organization by which it chooses to conduct its interstate business.

In addition to these concerns, the Seventh Circuit's decision makes it possible that any state participating in the Multistate Tax Commission's joint audit program could be required to defend its assessments proposed under their respective laws in the federal courts of any of the jurisdictions in which the Multistate Tax Commission maintains offices, irrespective of the nature of the claim. The Multistate Tax Commission is therefore concerned that the Seventh Circuit's decision in this case will result in opening the federal courts to a new class of federal constitutional litigation: shareholders litigating in federal court the state tax claims of their corporations in states other than the state whose laws have been called into

question. The Multistate Tax Commission believes state tax challenges in our federal system are more properly brought in the first instance in the taxing state's own forums.

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## INTRODUCTION AND SUMMARY OF ARGUMENT

Foreign parent corporations bypassing their subsidiaries' available state remedies to challenge in federal court their domestic subsidiaries' state taxes must clear at least two hurdles. First, a parent corporation must establish a justiciable claim arising out of its domestic subsidiary's payment of the state tax being challenged. This is the issue of standing. Second, assuming standing, a parent corporation must also establish the federal court's authority in the first instance to entertain and resolve the state tax claim. This is the question of whether the Tax Injunction Act, 28 U.S.C. §1341, or considerations of comity and federalism, require dismissal. In this brief, the latter concerns are called "Our Federalism."<sup>1</sup>

While standing and "Our Federalism" can be interrelated as they are in this case, the two issues raise different considerations. Standing deals with a specific party's accessibility to judicial proceedings to resolve a specific claim. Dismissal under the doctrine of "Our Federalism," on the other hand, preserves our federal system by requiring a litigant with standing to resort to available

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<sup>1</sup> *Fair Assessment in Real Estate Assn. v. McNary*, 454 U.S. 100, 103 (1981), notes that "Our Federalism" encompasses both the Tax Injunction Act and the principle of comity.

state remedies in the first instance. Alcan and Imperial have not established their standing nor have they established sufficient reasons for avoiding dismissal under the doctrine of "Our Federalism."

This brief limits its discussion to consideration of the second issue - why the doctrine of "Our Federalism" requires dismissal. The Multistate Tax Commission limits its discussion to "Our Federalism", because it believes the strength of that doctrine supports a general rule that parent corporations, whether foreign or domestic, may not bypass in federal court state remedies available to their subsidiaries.

In furtherance of the Multistate Tax Commission's restricted treatment of this case, this brief's discussion of the alleged injuries of Alcan and Imperial is for the limited purpose of demonstrating that their claimed injuries can only be indirect and derivative. While the indirect and derivative nature of these injuries supports the Franchise Tax Board's position that Alcan and Imperial have no standing, the indirect and derivative nature of the claimed injuries also supports application of the doctrine of "Our Federalism." Dismissal should occur here, because the parent corporations' injuries, no matter how described, are simply too intertwined with the refund claims of the subsidiaries now pending in state proceedings to be considered independently by the federal courts.

Dismissal will promote our federal system by providing the California state courts the first opportunity to resolve a matter of important state interest. The importance of state tax administration is manifested in federal

legislation, such as the Tax Injunction Act, 28 U.S.C. §1341, the principle of comity, and the numerous decisions of the Court. "Our Federalism" is appropriately applied here, because (i) Alcan and Imperial have not made any attempt to determine if they can vindicate their interests through the pending state tax refund proceedings of their subsidiaries; and (ii) application of this Court's derivative preclusion concepts<sup>2</sup> indicates that adequate state remedies are in any event available to resolve all of the complaints of the actual taxpayers and their parent corporations. The facts of this case are not significantly different from other state tax and non-state-tax cases in which the Court has applied the doctrine of "Our Federalism" as manifested in the Tax Injunction Act and the principle of comity.

The fact that the underlying issues of these cases involve foreign commerce does not detract from these conclusions for two reasons. First, the ultimate issue – the constitutionality of applying the world-wide unitary business principle in the taxation of a domestic subsidiary corporation of a foreign parent – is not yet properly before the Court. Second, this Court has not deviated from its principle that where adequate state remedies exist, state tax cases are best resolved in the first instance in state forums. In effect, as to the preliminary issue of what forums are available to a litigant to resolve federal

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<sup>2</sup> "Derivative preclusion" in this context refers to the application of the principle of comity where there is an inter-relationship among the federal court plaintiffs (the parent corporations), the state litigants (the tax paying subsidiaries), and the issues presented by each of these entities. See pp. 11-12, 20-25, *infra*.

constitutional challenges to state taxes in the first instance, the United States has spoken with uniformity: the federal government respects federalism by avoiding intrusive interference with state taxation until after state forums have had the full opportunity to review the matter themselves.

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## ARGUMENT

### THE DOCTRINE OF "OUR FEDERALISM" WHICH IS MANIFESTED IN THE TAX INJUNCTION ACT AND IN THE PRINCIPLE OF COMITY REQUIRES THIS MATTER TO BE DISMISSED.

There are two separate elements to "Our Federalism" which have application here: the Tax Injunction Act, 28 U.S.C. §1341, and the principle of comity.<sup>3</sup> Both grounds are derivative of federalism and can be jointly discussed.

Prior to the adoption of the Tax Injunction Act in 1937, Act of August 21, 1937, 50 Stat. 738, federal courts sitting in equity had exercised their prerogative to withhold relief in favor of public interest (state tax administration) when the private rights sought to be vindicated would not suffer. *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293, 297-98 (1943). Supreme Court review of any federal question remaining after conclusion of the state legal proceedings sufficiently protected the private

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<sup>3</sup> The Court in *Fair Assessment in Real Estate Assn. v. McNary*, 454 U.S. 100, 103 (1981), noted that the Tax Injunction Act and the tradition of withholding federal court review of state taxes are derived from "Our Federalism."

litigant's rights without disturbing state administration of taxes. *Id.* at 301. This judicial protection of state tax administration, which has not changed, *Fair Assessment in Real Estate Assn. v. McNary*, 454 U.S. 100 (1981), appropriately reflects considerations of federalism:

"The scrupulous regard for the rightful independence of state governments which should at all times actuate the federal courts, and a proper reluctance to interfere by injunction with their fiscal operations, require that such relief should be denied in every case where the asserted federal right may be preserved without it." . . . Interference with state internal economy and administration is inseparable from assaults in the federal courts on the validity of state taxation, and necessarily attends injunctions, interlocutory or final, restraining the collection of state taxes. These are the considerations of moment which have persuaded federal courts of equity to deny relief to the taxpayer. [*Great Lakes Co.*, 319 U.S. at 298 (quoting *Matthews v. Rogers*, 284 U.S. 521, 525 (1932))].

Congress recognized and gave sanction to this practice of the federal equity courts by its passage of Tax Injunction Act. *Id.* Subsequently, the application of the same principle of comity was applied to cases which could be described as sounding in law. *Fair Assessment, supra*.

The legislative history of the Tax Injunction Act discloses that the primary concern of Congress in passing the Act was the divestiture of federal court jurisdiction to interfere with state tax administration and not so much the form of the remedy available in the federal courts. *California v. Grace Brethren Church*, 457 U.S. 393, 409 n.22 (1982). To accommodate these concerns and to be faithful

to this congressional intent, the "plain, speedy and efficient remedy" exception to the Tax Injunction Act is narrowly construed. *Id.* at 413.

Consistent with the narrow interpretation of the "plain, speedy and efficient remedy" exception to the Tax Injunction Act, the Court has interpreted that Act to bar claims which are not within its literal language but whose consideration by the federal courts would be inconsistent with the purpose of the Act. *Grace Brethren, supra* (Tax Injunction Act applies to declaratory judgment cases even though the statutory language speaks in terms of injunctions). The Court has further indicated that a separate claim which does not directly involve the enjoining, suspending or restraining of the assessment, levy or collection of a state tax may nevertheless be barred by the Tax Injunction Act. Thus, a claim challenging a federal law, and not a state tax, is still barred within the same lawsuit, when the resolution of the question of the federal law would necessarily resolve the state tax claim, which is obviously also barred. *Grace Brethren, supra* at 418 n.38. To hold otherwise would not promote the policy of drastically limiting federal interference in the administration of state taxes. *Id.*

The Tax Injunction Act does not supplant possible application of the principle of comity in federal court cases involving state taxation. *Great Lakes Co., supra* at 299; *Fair Assessment, supra*. Therefore, "even where the Tax Injunction Act would not bar federal-court interference in state tax administration, principles of federal equity practice may nevertheless counsel the withholding of relief." *Rosewell v. LaSalle Nat'l Bank*, 450 U.S. 503, 526 n.33 (1981).

The principle of comity in state tax cases is attributable to considerations of federalism. *Fair Assessment, supra*. *Younger* abstention, which is derived from the seminal case of *Younger v. Harris*, 401 U.S. 37 (1971), also reflects comity and federalism. *Younger* abstention originated in the context of federal courts interfering with ongoing state criminal proceedings. Today *Younger* abstention has been extended to ongoing state civil proceedings involving matters of significant state interest. E.g., *Ohio Civil Rights Commn. v. Dayton Christian Schools, Inc.*, 477 U.S. 619 (1986) (ongoing state administrative hearing). The Court has indicated that *Younger* abstention reflects the concern of comity and not merely the existence of ongoing state proceedings. *Juidice v. Vail*, 430 U.S. 327, 334 (1977).

*Younger* abstention is closely related to the principle of comity which is applied in state tax cases. *Colorado River Water Conservation District v. United States*, 424 U.S. 800, 816 (1976) (*Younger* abstention and state tax comity classified as the same general type of abstention); *Samuels v. Mackell*, 401 U.S. 70 (1971) (bases *Younger* abstention in declaratory judgment action on *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293 (1943)).<sup>4</sup> If anything, historically it was more difficult to invoke *Younger* abstention than state tax comity, because *Younger* abstention was at first thought applicable only where there was an ongoing state criminal, or at least civil, judicial proceeding. Compare *Younger, supra*, *Huffman v. Pursue, Ltd.*, 420 U.S. 592

<sup>4</sup> In any event the various forms of abstention are not "rigid pigeonholes into which federal courts must try to fit cases." *Pennzoil Co. v. Texaco, Inc.*, 481 U.S. 1, 11 n.9 (1987).

(1975), and *Fair Assessment, supra* at 112, with *Dayton Christian Schools, supra*. *Younger* abstention illustrates the principle of comity which bars federal suits in the state tax area. *Fair Assessment, supra* at 112.

The Tax Injunction Act, the principle of comity in state tax cases and *Younger* abstention do not apply, if the ongoing state proceedings are inadequate to protect the federal interests sought to be vindicated. 28 U.S.C. §1341 ("plain, speedy and efficient remedy" exception); *Fair Assessment, supra* at 116. But where "a litigant has not attempted to present his federal claim in related state court proceedings, a federal court should assume that state procedures will afford an adequate remedy, in the absence of unambiguous authority to the contrary." *Pennzoil Co. v. Texaco, Inc.*, 481 U.S. 1, 15 (1987).

The *Younger* abstention requirement that the federal plaintiff be involved in ongoing state proceedings has not prevented the Court from recognizing that federal plaintiffs who are not involved as parties in the state proceedings may nonetheless be barred by *Younger* abstention. *Middlesex County Ethics Committee v. Garden State Bar Assn.*, 457 U.S. 423, 437 n.17 (1982); *Hicks v. Miranda*, 422 U.S. 332, 348-49 (1975). Thus, derivative preclusion under *Younger* abstention applies when the interests of the non-party federal plaintiffs are intertwined with the state parties and interference with the pending state proceedings is sought. *Hicks, supra* at 348-49. In the Court's view, it is the interrelationship of the parties as to "ownership, control and management" which determines whether the interests of the nonparty federal plaintiff are so intertwined with the state party that *Younger* dismissal is required. *Doran v. Salem Inn, Inc.*, 422 U.S. 922, 928-29

(1975). Basically, the Court has indicated that derivative preclusion will apply in *Younger* abstention, if the non-party federal plaintiff by reason of his relationship with the state party can preserve and vindicate his rights. *Hicks, supra* at 348-49. *Doran, supra* at 928-29.

Thus, the Court has held that an employer who operated a theater showing the film *Deep Throat* was nonetheless barred by *Younger* abstention from maintaining a federal action challenging state obscenity laws where state proceedings were ongoing which involved the employer's employees and the film itself. *Hicks, supra*. In addition, some Justices of the Court would similarly apply this form of derivative preclusion under *Younger* abstention to a union seeking to assert in federal court the interest of its members, even though the organization had some interests which may be separate and independent of its members. *Allee v. Medrano*, 416 U.S. 802, 830-31 (1974) (Burger, C.J.) (concurring and dissenting opinion). This view has apparently found some favor with a majority of the Court. See *Hicks, supra* at 340 (quoting favorably a portion of Chief Justice Burger's observations in *Allee v. Medrano*).

The Court has not applied derivative preclusion in *Younger* abstention, however, where the federal court plaintiffs and the state party are totally unrelated, *Doran, supra* (three independent bar owners who were unrelated as to ownership, control and management but who had a common issue); or where the unrelated state court party is asserting an interest personal to her, *Steffel v. Thompson*, 415 U.S. 452 (1974) (two unrelated handbillers where there was no factual indication state criminal defendant would seek or be able to vindicate the nonparty federal plaintiff's rights).

Application of the foregoing authorities to the facts in this case results in the conclusion that both the Tax Injunction Act and the principle of comity bars these actions.

**A. The Alleged Injuries Of Alcan And Imperial At Best Are Indirect And Derivative Of The Direct Injuries Their Domestic Subsidiaries Would Necessarily Have Suffered As The Actual Taxpayers.**

As a preliminary matter, your *Amicus* will demonstrate that the claimed injuries of Alcan and Imperial at best are described as indirect and derivative of the direct injuries their domestic subsidiaries would necessarily have to suffer as the actual taxpayers. Our purpose here is not to argue standing which has already been effectively accomplished by the Franchise Tax Board. Rather, your *Amicus* submits that the indirect and derivative nature of the claimed injuries of Alcan and Imperial establish that these injuries are inextricably intertwined with the issues presented by the subsidiaries in their pending state tax refund proceedings. This close interrelationship requires that these actions be dismissed under "Our Federalism."

In the course of these proceedings, Alcan and Imperial identified two injuries to support their access to federal court, both of which the Seventh Circuit rejected:

1. Use of the unitary business principle results in an alleged substantial compliance burden on the foreign parent corporations; and
2. Use of the unitary business principle results in alleged double taxation of income in which the

foreign parent corporations have an interest. Pet. for Writ of Cert. A-13 to A-14.

The Seventh Circuit on its own developed a third possible injury:

Use of the unitary business principle allegedly burdens foreign companies' decisions to conduct business through subsidiaries (allegedly resulting in a higher state tax burden) than if they used an independent contractor (allegedly resulting in a lower state tax bill). Pet. for Writ of Cert. A-15 to A-17.

The above proffered injuries at best establish an indirect and derivative injury in the parent corporations.

Part of the problem with contending that the above identified injuries are the separate injuries of the parent corporations is that it is unclear whether this argument is premised on the unitary business principle or the "arm's length/separate accounting" principle. The Multistate Tax Commission submits that notwithstanding this confusion, analysis of the claimed injuries under either the unitary business principle or the arm's length principle supports the conclusion that the parent corporations' claimed injuries are indirect and derivative.

#### 1. Unitary principle.

Alcan and Imperial do not contest in these proceedings that the foreign parent corporations and their domestic subsidiaries are engaged in a unitary business.<sup>5</sup>

<sup>5</sup> In this context, unitary business means a business the activities of whose members (in the case of a multicorporate structure) are so functionally integrated as to be engaged in a single enterprise. *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 165, 178-79 (1983).

(J.A. 54, para. 30; J.A. 63, "Issues;" J.A. 68-9, para. 17). The absent parent corporations establish their alleged injury, if any, through the state taxation of their subsidiaries, which are supplying the nexus for state taxation. See *Container*, *supra* at 164-66. The alleged injuries of the parent corporations cannot be viewed as direct and independent when the instate, domestic subsidiary is engaged in a unitary business.

Thus, alleged double taxation cannot exist, for example, unless the taxing state is using the unitary principle to tax *through the instate subsidiary* income which, under the standards of the foreign commerce clause, is not properly attributable to the subsidiary. Similarly, the administrative compliance burden of being a unitary business rests directly upon the instate domestic subsidiary which must pay any tax or penalty resulting from its failure to comply. Finally, the instate domestic subsidiary corporation must pay the alleged discriminatory tax which purportedly makes utilization of the instate subsidiary unattractive to the absent parent.

In short, under the unitary principle the instate subsidiary corporation can be the only directly injured party, because it is the actual taxpayer supplying the nexus for taxation and no injury can even indirectly occur to the parent at all without the very same injury directly occurring to the subsidiary.

#### 2. Arm's length principle.

Utilizing the arm's length principle to analyze the parent corporations' claimed injuries is conceptually difficult. The arm's length principle treats each corporate

entity as separate so that action taken against one corporation conceptually could not cause a *direct* injury against another corporation which was absent from the state taking the action. Nonetheless, assuming one can find causation using the arm's length principle, your *Amicus* does not see how the parent corporation's claimed injuries can be viewed as direct and independent.

Under the arm's length principle, alleging double taxation is tantamount to claiming that the taxing state is taxing income which is not properly apportioned or attributed to the instate subsidiary. Alcan and Imperial have advanced no reason why the instate subsidiary, as the taxpayer whose income has been thus inappropriately increased, is not the party directly injured.

The compliance burden under the arm's length principle cannot be placed at the level of the parent corporation at all. Under the arm's length principle, the instate, domestic subsidiary would be obligated to reimburse the foreign parent corporation for its work. Cf. *Rev. Rul. 78-430*, 1978-2 C.B. 181 (arm's length rules of §482 of the Internal Revenue Code require arm's length compensation for management, bookkeeping and consulting services rendered by another corporation).

The alleged discrimination arising from the choice of business organization with which to conduct foreign commerce injures the domestic subsidiary, because according to the Seventh Circuit's logic *the domestic subsidiary* incurs higher taxes than would an independent contractor. Here again, it is the instate, domestic subsidiary which should complain.

It should be apparent from the foregoing discussion that the claimed injuries of the parent corporations in this case are indirect and derivative of their subsidiaries' claims under either unitary or arm's length principles. After all, it is the factors used to calculate the *instate subsidiaries'* taxable income which are being called into question.

The instate, domestic subsidiaries, as the directly injured parties, are the appropriate representatives to challenge California's use of the unitary business principle to the unitary business. The Multistate Tax Commission cannot understand how the final resolution of the domestic subsidiaries' direct injury in the pending state tax refund proceedings, which includes a possible appeal to this Court, would not necessarily also resolve any claim the parent corporations may have, no matter what the nature of the parents' claims. This means that the parents' claims, however described, are too inextricably intertwined with the refund claims of the subsidiaries to be independently resolved by the federal courts. The parent corporations by virtue of their absolute ownership and control of their wholly owned subsidiaries can preserve their federal rights by controlling their subsidiaries' utilization of the available state remedies. (J.A. 41, para. 6; J.A. 66, para. 8 and Ex. 1 to Alcan Stip.). The remaining portions of this brief will demonstrate under the Court's precedent why this is so.

**B. The Tax Injunction Act Applies, Because The Foreign Parents Have An Effective Remedy Under California Law.**

No one questions the adequacy of California's remedy, *qua* remedy. The only question presented by Alcan's and Imperial's opposition to application of the Tax Injunction Act is whether the California remedy is available to vindicate the parents' interests.

Given the true nature of the parent corporations' injuries, it belies reality to argue that the remedy available to the foreign parents through their wholly owned domestic subsidiaries does not afford an adequate remedy within the meaning of the Tax Injunction Act. The indirect and derivative injuries allegedly suffered by the parent corporations are in fact best represented by the domestic subsidiary whose direct economic interest is at stake.

To apply the "plain, speedy and efficient remedy" exception of the Tax Injunction Act here would not give proper deference to Congressional intent to divest the federal courts of jurisdiction to interfere with the administration of state taxation. *Grace Brethren, supra* at 409 n.22. After all, the Tax Injunction Act requires dismissal of a challenge to a federal law which does not directly involve a challenge to a state tax, when resolution of the federal question will necessarily resolve the state law claim, which is also being dismissed. *Grace Brethren, supra* at 418 n.38. It should be equally appropriate to apply the Tax Injunction Act to intertwined, related parties as the Court does to intertwined issues, where resolution of the

related state party's case will necessarily resolve the federal plaintiffs' case. This Court will be available to review the federal law claims which a related (or derivative) party does not believe were properly resolved in the related state proceedings.

The Court has suggested as much in cases dealing with the analogous circumstance involving the Anti-Injunction Act, 26 U.S.C. §7421(a). In cases involving the Anti-Injunction Act, the Court has suggested that formalisms in the identities of the parties will not avoid dismissal. *South Carolina v. Regan*, 465 U.S. 369, 381 n.19 (1984) (organization of taxpayers could not successfully argue that it was without alternative remedies); *see also Bob Jones University v. Simon*, 416 U.S. 725, 747 n.21 (1974) (third parties in suits involving taxes may be able to afford a taxpayer a sufficient remedy).

**C. The Principle of Comity Applies, Because There Has Been No Clear Showing That The Interests Which The Foreign Parent Corporations Seek To Preserve Cannot Otherwise Be Protected By Resort To Their Subsidiaries' State Remedies, Thereby Avoiding Unnecessary Federal Action**

Federal plaintiffs seeking to bypass state remedies available in related state proceedings have a special burden to establish that their interests cannot be protected in these related state proceedings. *See Pennzoil, supra* at 14-17; *Middlesex County Ethics, supra* at 435 (inadequacy of state remedy must plainly appear); *Hicks, supra* at 349 (federal plaintiffs must make "clear showing" state remedies are inadequate). Alcan and Imperial have failed

in this endeavor. Indeed, Alcan's and Imperial's failure to attempt to vindicate their alleged interests through the state remedies available to their domestic subsidiaries justifies this Court assuming that such rights could be vindicated in the pending state tax refund proceedings. *Pennzoil*, *supra* at 15.

The fact that the parent corporations may not be actual state parties in the pending state refund proceedings should not prevent the Court from applying *Pennzoil*, because it is clear that the parents absolutely control their domestic subsidiaries through 100% ownership of the subsidiaries' stock. In addition, the parents' derivative claims will necessarily be resolved in the subsidiaries' pending state tax refund claims. Resolution of the federal constitutional claim held by the subsidiaries will necessarily resolve the parents' claims. To the extent there is any ambiguity in California law on this point, which the Multistate Tax Commission submits is not the case, Alcan and Imperial may not be heard to complain. *Pennzoil*, *supra* at 14-15. The record discloses that no harm will occur to Alcan and Imperial from dismissing their injunctive and declaratory actions in favor of the pending state tax refund proceedings which have been commenced by their domestic subsidiaries. *Great Lakes Co.*, *supra* at 297-98. These preliminary observations alone support the dismissal of this case under the principle of comity.

Apart from relying on Alcan's and Imperial's failure of proof, the record itself supports the Franchise Tax Board's assertion that the principle of comity is applicable in any event. Thus, the facts indicate that apart from the derivative party and derivative issue aspects of this

case, the threshold for applying *Younger* abstention exists.<sup>6</sup> The facts of this case do not even require reference to the special class of state tax cases which deal with the principle of comity. This means that the derivative preclusion principles which have been developed in *Younger* abstention cases would have independent operation without regard to this case involving state taxes. Direct application of *Younger* abstention, as opposed to state tax comity, in this case is, however, somewhat theoretical, because the Court has recognized that the comity principle applied in *Younger* abstention is illustrative of the same principle to be applied in state tax comity cases. *Fair Assessment*, *supra* at 111-12. Indeed, the principle

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<sup>6</sup> The threshold for applying *Younger* abstention appears easily met here, because this matter involves an application for the intervention of the federal courts in ongoing state judicial and quasi judicial proceedings involving matters of substantial importance to the states (taxation). *E.g.*, *Fair Assessment*, *supra*; *Great Lakes*, *supra*. Whether the difference in parties and the alleged issues would avoid *Younger* abstention is discussed in the main text.

Your *Amicus* parenthetically notes at this point that this action is especially intrusive, because the Franchise Tax Board, which is a California state governmental agency, is a party defendant in these proceedings and there are at the same time pending state tax refund proceedings. While *Ex parte Young*, 209 U.S. 123 (1908), allows the bringing of a prospective injunctive (or now a declaratory) action against state officials who are alleged to have exceeded their authority under federal law, that exception does not apply when the suit is directly against a state. In addition, the presence of ongoing state tax refund proceedings make these actions exceedingly close to a federal suit for the refund of state taxes, which is clearly not permitted. *Ford Motor Co. v. Dept. of Treasury*, 323 U.S. 459 (1945); *Great Northern Life Ins. Co. v. Read*, 322 U.S. 47 (1944).

of comity applied in state tax cases has suggested the same kind of practical solution to derivative preclusion which is advocated here. *Grace Brethren, supra* at 418 n.38 (derivative issue preclusion applied). So regardless of whether this matter is treated as a *Younger* abstention case or a state tax comity case, the result should be the same.

Dismissal in this case is appropriate notwithstanding the fact (i) the parent corporations allege they are asserting an independent interest and (ii) the parent corporations themselves are not involved in the pending state proceedings and apparently cannot participate as a state party. The Court's opinions in *Hicks, supra*, and *Doran, supra*, prove the point.

*Hicks* and *Doran* have advocated a practical approach to applying comity in situations involving the possible application of derivative preclusion. Since application of comity seeks to avoid unnecessary federal intrusion where the federal rights can still be preserved through state proceedings, the focus of the Court is on whether the state proceedings will be available to vindicate the nonparty federal plaintiff's rights. Specifically, the Court has indicated that a federal court should not proceed, if the issues presented by the nonparty federal plaintiff and the state party are intertwined and the parties are related by ownership, management and control. *Hicks, supra* at 348-49; *Doran, supra* at 928-29. It would elevate form over substance not to dismiss a nonparty federal plaintiff's suit where in practical effect the nonparty federal plaintiff controlled the ongoing state proceedings and is in a position to ensure that its rights are preserved. See *Allee v. Medrano*, 416 U.S. 802, 831 (Burger, C.J.) (concurring and

dissenting opinion) ("The requirements of *Younger* are not to be evaded by artificial niceties.")

The facts of this case clearly call for derivative preclusion application of the comity principle for several reasons. First, since *Alcan* and *Imperial*, for purposes of this proceeding, have not challenged the finding of a unitary business, it must be conceded that the business of the subsidiary is so functionally intergrated with that of the parent corporations as to be a single business. *Container, supra* at 165, 178-79. This relationship results in a flow of value not only from the functional integration, but also from centralization of management and economies of scale. *Id.* The underlying foreign commerce issue which will ultimately be presented, therefore, affects the instate subsidiaries as integral members of this unitary business. The instate subsidiaries are the corporate entities which must bear the direct burden of the alleged unconstitutional tax.

Second, the unitary business ensures that there is a single business with an identity of economic activities and interests among its separate members. It follows that there is no reasonable prospect that the subsidiaries for their own practical benefit will abandon the fight on behalf of the unitary group. If the Court was willing to apply derivative preclusion in favor of an ongoing state criminal proceeding with all its uncertainty in final resolution, *Hicks, supra*, then certainly it should be applied in the civil context where the interrelated, but separate, parties have the same economic interests.

Third, the only direct injury which can be identified is that of the instate subsidiaries which are subject to the

state tax at issue. The parent corporations' alleged injury is entirely derivative of the action being taken against their subsidiaries. Final resolution of the subsidiaries' ongoing state tax refund claims will necessarily fully resolve the parent corporations' claims.

Fourth, the parent corporations by virtue of their absolute control over the domestic subsidiaries arising from 100% ownership totally dominate and control the subsidiaries' ongoing state tax refund proceedings. Nowhere is this more evident than in the fact that the subsidiaries have not been pressing for resolution of their tax refund claims but the parent corporations have been quite active here.

Fifth, this action was obviously commenced to avoid the consequences of and to interfere with the ongoing state tax refund proceedings. This is established by Alcan's persistent forum shopping and by the fact that the subsidiaries are not pressing for the resolution of their tax refund claims. All parties apparently recognize that final resolution of the parent corporations' foreign commerce claims on the merits would necessarily eliminate the necessity of proceeding with the subsidiaries' refund claims. If the subsidiaries had any different interests to vindicate, your *Amicus* suggests they would independently be pushing to have their refund claims resolved. This federal suit has already had, therefore, an intrusive effect on an ongoing state proceedings involving matters of substantial importance to the states. As previously noted, the intrusive effect is heightened by the fact that resolution of the parent corporations' declaratory and injunctive claims will undoubtedly impose the

result to be applied in the refund proceedings. See n. 6, *supra*.

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## CONCLUSION

While Alcan and Imperial have fashioned a claim they hope will keep them in federal court, application of "Our Federalism" prevents this attempt from being successful. Given the indirect and derivative nature of the claim pressed, either the Tax Injunction Act or the principle of comity bars these actions. Alcan and Imperial quite frankly have not met their burden of establishing that the related pending state tax refund proceedings do not provide them with the opportunity of vindicating their alleged federal constitutional rights. Indeed, the record affirmatively discloses that by utilizing their subsidiary corporations' pending state tax refund proceedings, Alcan and Imperial do enjoy the right to present their claims and preserve their alleged federal interests. This Court should not deviate from its uniform position that with rare exception any challenge to state taxation must be first heard in the forums of the taxing state.

Respectfully submitted,

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June 8, 1989

NO. 1 1950

**Department of the United States**

**Patents for Invention of Chemicals, et al.**  
**Following**

**Acetylene, Chlorine and Ethanol Chemicals**  
**Manufactured**

**Following**

[REDACTED]

[REDACTED]

May 1, 1950      **United States Patent Office**

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No. 88-1400

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IN THE

**Supreme Court of the United States**

OCTOBER TERM, 1988

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FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, *et al.*,

*Petitioners,*

v.

ALCAN ALUMINIUM LIMITED AND IMPERIAL CHEMICAL  
INDUSTRIES PLC,

*Respondents.*

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ON WRIT OF CERTIORARI TO THE UNITED STATES  
COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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BRIEF AMICUS CURIAE  
OF SHELL PETROLEUM N.V.  
IN SUPPORT OF RESPONDENTS

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**PRELIMINARY STATEMENT**

Shell Petroleum N.V. ("SPNV") files this brief *amicus curiae* with the consent of all parties in order to put before the Court certain views as to (1) whether a foreign parent company of an American subsidiary has standing in federal court to challenge, under the Foreign Commerce Clause, the "upstream" application of a state franchise tax imposed by California on the income of a "unitary business" of which the foreign parent is the head; and (2) assuming standing does exist under

such circumstances, whether a federal action for injunctive and declaratory relief is nevertheless barred by the Tax Injunction Act or the principle of comity underlying that Act.

The Seventh Circuit held below that a foreign parent company has standing in federal court to pursue an action of this type. *Alcan Aluminium Ltd. v. Franchise Tax Board* ("Alcan"), 860 F.2d 688, 699-700 (7th Cir. 1988). In so doing, the Seventh Circuit acknowledged an "arguable conflict", *id.* at 688 n.\*, with two decisions of the Ninth Circuit denying standing to foreign parent companies to pursue such an action. *EMI Ltd. v. Bennett*, 738 F.2d 994, 996-99 (9th Cir.), *cert. denied*, 469 U.S. 1073 (1984); *Shell Petroleum N.V. v. Graves*, 709 F.2d 593, 595-96 (9th Cir.), *cert. denied, sub nom. Shell Petroleum N.V. v. Franchetti*, 464 U.S. 1012 (1983).<sup>1</sup> SPNV was the plaintiff in one of those Ninth Circuit actions and litigated in that action, among other things, the issue of a foreign parent company's standing to raise such a constitutional challenge under the Foreign Commerce Clause.

The *Alcan* case, like SPNV's prior action, arises in the context of the California Franchise Tax Board's (the "FTB") attempts to apply a franchise tax "upstream" from the nominal taxpayer to the combined income of that nominal taxpayer's foreign parent company and its worldwide subsidiaries and affiliates. However, unlike SPNV, the foreign parents involved here—*Alcan Aluminium Ltd.* ("Alcan"), a Canadian corporation, and *Imperial Chemical Industries PLC* ("Imperial"), a British corporation—are not companies of countries that are parties to post-war Treaties of Friendship, Commerce and Navigation ("FCN Treaties"). SPNV is a company of The Netherlands, which is a party to such an FCN Treaty. As a result, SPNV is a beneficiary of special rights and protections provided pursuant to that FCN Treaty. SPNV has asserted treaty-based claims against California's attempts to apply its

<sup>1</sup> The decision in *Alcan* also apparently conflicts with a ruling by the Second Circuit in *Alcan Aluminum [sic] Ltd. v. Franchise Tax Board* ("Alcan I"), 558 F. Supp. 624, 629 (S.D.N.Y.), *aff'd mem.*, 742 F.2d 1430 (2d Cir. 1983), *cert. denied*, 464 U.S. 1041 (1984).

unitary tax "upstream", in addition to the constitutional claims asserted by respondents here. The special rights and protections accorded SPNV and other foreign parent companies benefitting from similar FCN Treaties add an important dimension, not presented here, to the issues of standing and the application of the Tax Injunction Act.

### INTEREST OF AMICUS CURIAE

SPNV is a company of The Netherlands and as such is accorded special rights and protections by the Treaty of Friendship, Commerce and Navigation of 1956 between the United States and The Netherlands, as well as general principles of international law. SPNV is also accorded certain rights and protections under the United States Constitution, both directly and by virtue of the "national treatment" guarantees of the FCN Treaty. These rights and protections may be affected by the decision herein.

SPNV has its principal place of business at The Hague. Sixty percent of the equity shareholding in SPNV is held by the Royal Dutch Petroleum Company, a company incorporated in The Netherlands ("Royal Dutch"). The remaining 40 percent is held by The "Shell" Transport and Trading Company PLC, a company incorporated in England ("Shell Transport").

SPNV and an affiliated company, The Shell Petroleum Company Limited, together hold, directly or indirectly, investments representing interests in over 900 other Royal Dutch/Shell companies operating in over 100 countries. Included among SPNV's holdings at the present time is an interest in Shell Petroleum Inc., which in turn holds all the outstanding shares of Shell Oil Company ("Shell Oil"). The majority of the remaining interest in Shell Petroleum Inc. is held by SPNV's parent, Royal Dutch, with the rest held directly by Shell Transport. Shell Oil has engaged in business in California and has been subject to the California corporate franchise tax. For at least some tax years (including a number of years during which SPNV directly held approximately 69% of the outstanding shares of Shell Oil), the FTB has attempted

to apply its unitary tax formula "upstream" so as effectively to tax not only the income of Shell Oil, but also the income of its foreign parent, SPNV, and all of SPNV's subsidiaries and affiliates worldwide. Those attempts were the subject of SPNV's prior litigation against the FTB.

As a foreign parent company that has litigated against California's attempts to combine, apportion and tax its income together with that of its worldwide affiliates and subsidiaries, SPNV has a special interest in the issues presented by the present case. Because SPNV is a foreign parent company entitled to rights and protections under the United States-Netherlands FCN Treaty and international law, as well as the Constitution, SPNV believes that it can present views not heretofore expressed which may be of use to the Court in resolving the issues presented.

SPNV submits this brief *amicus curiae* to support the position taken in this litigation by the respondents and to place before the Court the distinctive considerations applicable to a foreign parent company protected by the principles of strict territoriality of taxation embodied in various FCN Treaties and international law.

### SUMMARY OF ARGUMENT

A foreign parent company of an American subsidiary has standing in federal court to challenge, under the Foreign Commerce Clause and the Due Process Clause of the Constitution, the attempted imposition of a state "unitary business" tax on the combined and apportioned income of that foreign parent and its worldwide subsidiaries and affiliates. The constitutional and prudential requirements of standing are satisfied by the direct injury of double taxation the foreign parent suffers independently of the injury suffered by the subsidiary due to any unfairness of the unitary tax formula.

The risk of double taxation falls more heavily on a foreign holding company parent that chooses as its instrumentality of foreign commerce a corporate subsidiary subject to the

"upstream" application of a unitary tax than it does on a domestic holding company parent making the same choice. This potential of a unitary tax to burden more heavily a foreign parent in its choice of its instrumentality of foreign commerce than a domestic parent making the same choice renders the "upstream" application of a unitary tax formula to a foreign parent unconstitutional under the Foreign Commerce Clause and the Due Process Clause of the Constitution. The foreign parent company has standing to raise that constitutional claim because it bears the added burden.

This double taxation injury is not mitigated by factors, such as those relating to "economies of scale", cited by this Court in its decision upholding the "downstream" application of the California unitary tax to an American parent company with foreign subsidiaries. *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 181 (1983) (quoting *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 438 (1980)). Nor do the factors used by the Court to distinguish the facts in *Container* from those in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979) (holding unconstitutional under the Commerce Clause California's application of an apportioned value added property tax to Japanese shipping containers subject to full taxation in Japan), apply with equal weight under the present circumstances.

A finding of standing as to at least some foreign parent companies is further mandated by the existence of Treaties of Friendship, Commerce and Navigation according those foreign parents special rights and protections regarding the manner in which they and their domestic subsidiaries are treated by the United States and state and local authorities. Those rights and protections do not vest in the domestic subsidiaries and those subsidiaries are without standing to prosecute the foreign parents' claims pursuant to such FCN Treaties.

The need for federal uniformity regarding taxation of instrumentalities of foreign commerce also supports a finding of standing. Article I, § 8, cl. 3 of the United States Constitution vests the federal government with the power to regulate foreign commerce. The Court has recognized that the federal govern-

ment's need to speak with one voice concerning matters of foreign commerce contributes to the heightened level of scrutiny necessary when analyzing the international application of a unitary tax. *Container*, 463 U.S. at 186; *Japan Line*, 441 U.S. at 448-51. The prudential concerns regarding standing should not act as a bar to the swift resolution of this important matter, which is preventing the federal government from assuring uniformity in an aspect of foreign commerce of great concern to many of its trading partners.

Finally, neither the Tax Injunction Act (28 U.S.C. § 1341) nor the principle of comity underlying that Act is a bar to suit for injunctive or declaratory relief in federal court by a foreign parent company. The Tax Injunction Act only bars suit in federal court by a party having a "plain, speedy and efficient remedy" in state court. California does not provide a remedy of any type to the foreign parent of an American subsidiary subject to "upstream" application of its unitary tax formula. Therefore, by its express terms, the Tax Injunction Act does not apply. The principle of comity underlying the Act should not serve to deny a foreign parent company the only forum in which it may seek redress for its double taxation injury.

## ARGUMENT

### I. The California Franchise Tax as Applied Violates the United States Constitution and Foreign Parents Have Standing in Federal Court to Challenge Such Application.

This case on the merits involves an issue not previously addressed by this Court: the constitutionality, under the Foreign Commerce Clause, of the "upstream" application of a state's unitary tax formula to the combined income of the nominal taxpayer, its foreign parent company and the worldwide subsidiaries and affiliates of that foreign parent.<sup>2</sup> The result of that "upstream" application is to include in the income subject to apportionment and taxation income which in no sense, legally or practically, belongs to the nominal taxpayer. In the cases in which the Court has previously addressed the

<sup>2</sup> This issue was specifically reserved by the Court in *Container*, 463 U.S. at 189 n.26, 195 n.32.

constitutionality of a unitary tax method, the parent company was both the nominal taxpayer and the litigant, and the state's unitary tax method was applied "downstream", combining and apportioning the corporate parent taxpayer's income with the income of its subsidiaries and affiliates not otherwise subject to taxation by that state.<sup>3</sup> The "upstream" application of a unitary tax method so as to reach across national boundaries and impose upon a foreign parent company a system of taxation at odds with the arm's-length method adopted by the United States and every other significant trading nation presents difficult issues not fully addressed by the Court's analysis of "downstream" international application of a unitary tax formula in *Container*, see pp. 19-23 *infra*. Moreover, the interests of international trading partners in protecting their nationals from this departure from the international norm and the consequent risk of retaliation are far stronger when a unitary tax method is applied "upstream" to a foreign parent, as in the present circumstances, than when it is applied "downstream" from an American parent to a foreign subsidiary, as in *Container*. See pp. 18-19 *infra*. See also *Container*, 463 U.S. at 195 n.32.

It is in this novel context that the Court must address the issue raised by petitioners: whether a foreign parent should have standing in federal court to seek redress for the direct injury inflicted upon it by the "upstream" application of a unitary tax formula.

#### A. Double Taxation, a Principal Constitutional Danger Accompanying a Unitary Tax, Is an Injury Imposed upon the Parent Company, Not the Subsidiaries.

A principal constitutional danger arising out of the application of a unitary tax formula is the risk of double taxation (assuming there is evidence of such double taxation). See, e.g., *Container*, 463 U.S. at 169, 170-71; *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 228-29 (1980); *Mobil*, 445 U.S.

<sup>3</sup> See, e.g., *Container*, 463 U.S. at 173-74; *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 313 (1982); *F.W. Woolworth Co. v. Taxation & Revenue Dep't*, 458 U.S. 354, 357-59 (1982).

443-45; cf. *Japan Line*, 441 U.S. at 451-52 (discussing the danger of double taxation in the context of an internationally applied and apportioned value added property tax). It was this risk that led Justice Powell to state in his dissenting opinion in *Container*:

"The principles enunciated in [*Japan Line*] should be controlling here: a state tax is unconstitutional if it either 'creates a substantial risk of international multiple taxation' or 'prevents the Federal Government from "speaking with one voice when regulating commercial relations with foreign governments."' " 463 U.S. at 198 (quoting *Japan Line*, 441 U.S. at 451).

Double taxation is an injury that a unitary tax formula imposes on the *parent*. It is not an injury that is suffered by the subsidiary. The subsidiary is taxed but once—in the present case, by California. The subsidiary may well be separately injured by being taxed on more income than is properly attributable to it, but that injury is not *double* taxation of the subsidiary.<sup>4</sup> Rather, the double taxation arises from the fact that the same income—income belonging to the parent company—has been taxed by more than one jurisdiction, under the

<sup>4</sup> Petitioners repeatedly assert that the Seventh Circuit rejected the argument that double taxation results in a direct and independent injury to a foreign parent company. FTB Brief at 14, 26, 36. As the decision of the Seventh Circuit makes clear, that assertion is incorrect. The Seventh Circuit did state that double taxation "*narrowly construed*" may be viewed as increased overhead that only inflicts injury on a foreign parent in its capacity as a shareholder. *Alcan*, 860 F.2d at 696 (emphasis supplied). But the Seventh Circuit rejected this narrow construction, stating:

"However, the arguments that *Alcan* and *Imperial* incur no direct and independent injury from costs plausibly viewed as burdens on their subsidiaries remains persuasive only so long as the relationship between parents and subsidiaries is viewed narrowly, focusing exclusively on the parents' status as shareholders. . . . This line of argument, however, ignores a second important feature of the relationship between the foreign parents

guise of taxing separate subsidiaries. This can be shown by a simplified example: Foreign Subsidiary A has "its" income, as measured by the internationally accepted arm's-length method, taxed by its host country; Domestic Subsidiary B has "its" income, as measured by an "upstream" unitary business apportionment formula, taxed by California; as alleged by respondents, because of the differences in methodology, California has included some of Foreign Subsidiary A's income, as defined by its host country, into the definition of Domestic Subsidiary B's income. Accordingly, that income has been taxed twice, even though Foreign Subsidiary A and Domestic Subsidiary B have each only been taxed once. The direct injury of that double taxation is logically imposed on the parent; it has paid tax through both subsidiaries on a single piece of income.<sup>5</sup>

# 1. The General Rule Denying Shareholders Standing to Sue Regarding Corporate Injuries Does Not Act as a Bar to Standing for a Parent Company to Seek Redress for its Double Taxation Injury.

A suit brought by a foreign parent company seeking relief from the injury caused by double taxation cannot properly be described as belonging to the class of "shareholder suits to redress injuries to their corporations". *Alcan*, 860 F.2d at 693. It is true that it is the parent company's status as the majority or

and their domestic subsidiaries: the subsidiaries are owned as instrumentalities of the foreign commerce of their parents." *Id.* at 697.

The Seventh Circuit found that the potential for a unitary tax formula to doubly tax the income of a foreign parent impermissibly burdens a foreign parent's choice of the manner in which it conducts its foreign commerce in a way that a domestic parent is not similarly burdened. This analysis of *the effect of double taxation on a foreign parent* led the Seventh Circuit to hold that "*Alcan's* and *Imperial's* injuries are direct and independent of the injury to their subsidiaries and standing should follow." *Id.*

<sup>5</sup> The domestic subsidiary presumably has a claim that it has have been *unfairly* taxed because of the improper inclusion of income to which it has no entitlement, but that is a different injury from *double* taxation, which is inflicted upon the parent company.

sole shareholder in a subsidiary subject to an "upstream" unitary tax that makes it possible for the parent to suffer the injury of double taxation. However, this does not transform the injury of double taxation into an injury suffered by the subsidiary.

If the double taxation injury were merely derivative of shareholder *status*, as petitioners suggest, FTB Brief at 35, one would expect all parties sharing that status to suffer similar injuries. Plainly this does not occur. Only one shareholder may own the greater than fifty percent share of the subsidiary giving it the controlling ownership necessary for California to deem the shareholder and subsidiary a "unitary business" and apply its unitary tax formula "upstream" to that shareholder's income. *Appeal of Douglas Furniture of California, Inc.*, [1981-1984 Cal. Transfer Binder] St. Tax Rep. (CCH) ¶ 400-646 (SBE January 31, 1984). Therefore, only one shareholder can suffer the double taxation injury. This double taxation injury clearly falls into petitioners' second category of exceptions to the rule denying standing to shareholders: that "where the stockholder suffers an injury separate and distinct from any injury suffered by other stockholders or the corporation itself". FTB Brief at 23 (citation omitted). See also *Cowin v. Bresler*, 741 F.2d 410, 415-16 (D.C. Cir. 1984).

With the exception of a case involving special First Amendment issues not applicable here, in every case cited by the Seventh Circuit or petitioners as an example of the rule barring standing to shareholders of a corporation the shareholder involved was seeking either to redress an injury suffered by the corporation or to substitute its judgment for that of the corporation.<sup>6</sup> No case cited by the Seventh Circuit or by

<sup>6</sup> E.g., *Corbus v. Alaska Treadwell Gold Mining Co.*, 187 U.S. 455, 463-65 (1903) (denying a shareholder standing "to coerce the directors of a corporation to an act which their judgment does not approve, or to substitute his judgment for theirs"); *Hawes v. City of Oakland*, 104 U.S. 450, 452-53, 462 (1881) (barring shareholder standing to pursue a corporate cause of action and invoke diversity jurisdiction when the corporation itself could not); *Gregory v. Mitchell*, 634 F.2d 199, 202 (5th Cir. 1981) (preventing controlling share-

petitioners involves the denial of standing to a shareholder to seek redress for a legal injury which, though connected to the shareholder's status as such, could not logically be suffered by the corporate entity.<sup>7</sup>

That a foreign parent company has standing should not be surprising, since in any "upstream" application of the unitary tax, the taxing authority is in effect substituting the parent for the subsidiary as the business unit subject to taxation. In other words, the taxing authority has already decided to disregard corporate structure in its definition of the unitary business, going so far as to include in the income base subject to apportionment income as to which the nominal taxpayer (the subsidiary) has absolutely no legal entitlement. Having made the choice to treat the unitary business as a single entity, of which the parent company is necessarily the owner and proprietor, it is unfair for the taxing authority to then hide behind formal corporate structure to call the subsidiary the taxpayer for standing purposes. The parent company should have standing

holders in a bank from suing as individuals under 42 U.S.C. § 1983 for alleged discriminatory treatment of the bank by state regulators); *Erlich v. Glasner*, 418 F.2d 226, 228 (9th Cir. 1969) (denying shareholder standing to sue under the Civil Rights Act for damages suffered by the corporation); *Sherman v. British Leyland Motors, Ltd.*, 601 F.2d 429, 439-41 (9th Cir. 1979) (sole shareholder in automobile dealership cannot sue in individual capacity for claims arising under Automobile Franchise Act, antitrust laws or pendent state claims for damages to the corporation); *Von Brimer v. Whirlpool Corp.*, 536 F.2d 838, 846-47 (9th Cir. 1976) (majority shareholder barred from suing for interference with corporation's contractual relations).

<sup>7</sup> Petitioners argue that it is "self-evident" that the only party that may be directly injured by the application of a unitary tax formula is the party against which the tax is nominally assessed. FTB Brief at 35. The FTB is mistaken in its implicit assumption that application of a unitary tax formula can only result in one form of direct injury. This Court has already acknowledged that international application of a unitary tax may result in at least two forms of injury: (1) unfair apportionment of income, and (2) discrimination against foreign commerce resulting from double taxation. *Container*, 463 U.S. at 170-71. The former injury is suffered by the nominal taxpayer, but the latter is always suffered by the parent company, which in an "upstream" combination is *not* the nominal taxpayer.

to challenge the "upstream" application of the unitary tax, just as the parent company clearly has standing to challenge "downstream" applications in which it is both the nominal taxpayer and the entity suffering the double taxation injury.<sup>8</sup>

**2. The Direct Injury of Double Taxation Suffered by a Foreign Parent as a Consequence of the "Upstream" Application of a Unitary Tax Satisfies Both the Constitutional and the Prudential Requirements of Standing.**

As the party that suffers the injury of double taxation, the foreign parent company is best situated to prosecute before a federal court a constitutional challenge (including one based upon the Foreign Commerce Clause) to a state's unitary tax scheme. As this Court made clear in *Warth v. Seldin*, 422 U.S. 490 (1975), "[t]he Art. III judicial power exists only to redress or otherwise to protect against *injury to the complaining party*, even though the court's judgment may benefit others collaterally." *Id.* at 499 (emphasis supplied). Just as the constitutional element of standing analysis requires that the injury

<sup>8</sup> The inapplicability in the present case of the general rule that shareholders lack standing to redress the injuries of their corporation can be demonstrated by a hypothetical example: Foreign Parent A owns a majority interest in Domestic Subsidiary B, but is not the sole shareholder; Foreign Parent A also owns other subsidiaries; Domestic Subsidiary B in turn has subsidiaries of its own; and only Domestic Subsidiary B does business in California. If California defines the "unitary business" subject to taxation as Domestic Subsidiary B and its subsidiaries—a "downstream" application—so that only the income of B and its subsidiaries is combined, apportioned and taxed, then Foreign Parent A does *not* have standing; the parent company in that example is in the same position as the other shareholders of Domestic Subsidiary B. However, if California defines the "unitary business" as including not only Domestic Subsidiary B and its subsidiaries but also Foreign Parent A and its subsidiaries—an "upstream" application from the nominal taxpayer to its parent—so that the income of A and its subsidiaries is combined, apportioned and taxed along with that of B and its subsidiaries, then Foreign Parent A *does* have standing; it stands in a quite different position from the other shareholders of Domestic Subsidiary B.

complained of be "to the complaining party", the prudential aspect of standing analysis requires "that the plaintiff generally must assert his own legal rights and interests, and cannot rest his claim to relief on the legal rights or interests of third parties". *Id.* (citations omitted). Where the injury complained of is *double* taxation, the foreign parent company is in the best position to place the issues involved before a court. Indeed, logically *only* the parent can satisfy both prongs of the *Warth* standing analysis for a double taxation claim; the subsidiary has standing to complain that it is *unfairly* taxed, but is not the party best situated to assert that its parent is *doubly* taxed.

Petitioners' statement that "the standing question essentially is whether the parent companies may challenge the constitutionality of tax assessments issued against taxpayer-subsidaries which are perfectly capable of pursuing the *same* constitutional claims", FTB Brief at 34 (emphasis supplied), ignores the fact that respondents are seeking standing to prosecute constitutional claims *not* shared with their taxpayer subsidiaries. Foreign parents such as respondents are not seeking "to litigate their subsidiaries' tax liability". *Id.* at 35. They seek to prosecute their own claims arising out of the double taxation they suffer as a result of petitioners' "upstream" application of the California unitary tax. To require a foreign parent, which has suffered constitutionally impermissible double taxation injuries that logically are not suffered by its American subsidiary, to prosecute those constitutional claims through that very subsidiary, as petitioners suggest, *id.* at 42-43, would turn standing doctrine on its head.<sup>9</sup>

<sup>9</sup> Petitioners go so far as to state:

"It also follows that the taxpayer-subsidaries *would be able to argue in the state courts that the alleged burdens imposed on their foreign parents* are of such a nature as to interfere with the congressional power to regulate foreign commerce." *Id.* at 48 (emphasis supplied).

This Court's reasoning in *Warth*, 422 U.S. at 499, makes clear that foreign parents should litigate directly the unconstitutionality of the burdens placed upon them.

**B. The "Upstream" Application of a Unitary Tax Imposes Upon a Foreign Parent a Greater Risk of Unremedied Double Taxation Than Is Imposed Upon a Domestic Parent.**

There is a distinct difference between a foreign parent company and a domestic parent company in the present context which further supports standing for the foreign parent company. The injury suffered by a foreign parent as a result of double taxation cannot be viewed merely as an increased cost of doing business through a subsidiary, a cost falling equally on both domestic and foreign parents choosing to do business in such a manner. As this Court's analysis in both *Container* and *Japan Line* concedes, international application of a unitary or apportioned tax carries with it an "enhanced risk of multiple taxation". *Container*, 463 U.S. at 185; *Japan Line*, 441 U.S. at 447-48. This "enhanced risk" of double taxation in the international context is primarily a result of "the absence of an authoritative tribunal capable of ensuring that the aggregation of taxes is computed on no more than one full value . . . ." *Container*, 463 U.S. at 185-86 (quoting *Japan Line*, 441 U.S. at 447-48).<sup>10</sup>

Like a foreign parent company, a domestic parent with foreign subsidiaries lacks a single authoritative tribunal before which it may resolve all instances of double taxation. However, because a domestic parent company by definition is a taxpayer within the United States, it always has the opportunity to come before the Supreme Court seeking redress for any double taxation resulting from the direct taxation of its income and the indirect taxation of a portion of that income through a subsidiary. See, e.g., *Container*, 463 U.S. at 163; see *Japan Line*, 441 U.S. at 447.<sup>11</sup> A foreign parent company, if denied standing,

<sup>10</sup> In addition, the degree of double taxation itself is greater in the context of an "upstream" application of a unitary tax formula to a foreign parent than in the context of either a "downstream" international application to a domestic parent or a purely domestic application. See pp. 19-23 & n.19 *infra*.

<sup>11</sup> Petitioners' suggestion that the Seventh Circuit's ruling grants foreign parents a remedy unavailable to American parents, FTB Brief at 36, is incorrect.

lacks even that partial remedy for any double taxation (assuming—as is the case for SPNV—that it does no direct business in the United States). It is this disparity in the risk of injury through *unremedied* double taxation that impermissibly burdens the foreign parent's choice to use a domestic subsidiary as its instrumentality of foreign commerce, violating both the Foreign Commerce Clause and the Due Process Clause of the Constitution.

Put another way, the foreign parent company must make a choice. It can conduct business directly in California, thereby running the substantial risk of international double taxation but at least giving itself access to American courts, as the nominal taxpayer, to challenge that double taxation of its income. Alternatively, it can conduct business in California through a domestic subsidiary, thereby running the same substantial risk of international double taxation, but—under petitioners' theory—being denied access to all American courts to challenge that double taxation and instead being left only with its subsidiary's general fairness challenge to the California tax. Or it can stay out of California altogether, acting only at arm's length with unrelated companies, in which case there is no danger of international double taxation.<sup>12</sup> To force a foreign parent company to make the choice outlined above—to compound the danger of international double taxation by the very act of denying the foreign parent standing to prove that double taxation—places an added burden on international commerce that a domestic parent does not have to face, because a domestic parent will always have standing, as the nominal taxpayer, in some American court.

<sup>12</sup> Petitioners recognize the choices faced by a foreign parent company, FTB Brief at 26-30 & nn.8 & 9, but fail to acknowledge the gravity of their implications. Petitioners attempt to discredit the Seventh Circuit's holding by stating that its reasoning comes to no more than a conclusion that foreign parent companies "suffer a cognizable injury simply because they are put to a choice and may prefer to do business in a different form". FTB Brief at 31 (emphasis in original). As the Seventh Circuit makes clear, it is the "potential for the unitary tax to *penalize* foreign ownership of American assets [that] distinguishes the unitary tax from . . . regulation that might cause comparable increases in the cost of doing business in California, but would presumably affect foreign and domestically owned operations fairly equally", thereby unconstitutionally burdening a foreign parent. *Alcan*, 860 F.2d at 697 (emphasis supplied).

In short, the combination of "upstream" application of the unitary tax and denial of standing to the foreign parent to challenge that application doubly punishes the foreign parent for its choice of a domestic subsidiary as the instrumentality of foreign commerce. The effect, if standing is denied in the present situation, is international double taxation for which there is no effective remedy in an American court for the entity that actually suffers the double taxation injury.

**C. Benefits Accorded Certain Foreign Parent Companies Pursuant to Treaties of Friendship, Commerce and Navigation Provide an Additional Basis for Holding That Such Parents Have Standing in Federal Court to Challenge the "Upstream" Application of a Unitary Tax Formula.**

Following the conclusion of World War II, the United States entered into a series of Treaties of Friendship, Commerce and Navigation, one purpose of which was "to give corporations of each signatory legal status in the territory of the other party, and to allow them to conduct business in the other country on a comparable basis with domestic firms". *Sumitomo Shoji America, Inc. v. Avagliano*, 457 U.S. 176, 185-86 (1982). SPNV is accorded special rights and protections pursuant to one such Treaty, signed by the United States and The Netherlands in 1956, and has previously argued to this Court that these rights include certain substantive rights to Netherlands parent companies concerning how they and their domestic subsidiaries—their "property, enterprises and other interests", Article I, ¶ 1—are treated by the United States and state and local authorities. Petition for a Writ of Certiorari, *Shell Petroleum N.V. v. Franchetti*, No. 83-586, at 13-18.<sup>13</sup> In

<sup>13</sup> As noted above, there are no treaty claims in the present case. Neither Canada nor the United Kingdom is a party to a post-war Treaty of Friendship, Commerce and Navigation with the United States. Instead, both are beneficiaries of a Treaty of Amity, Commerce and Navigation of 1794 between the United States and Great Britain. This and other early commercial treaties negotiated by the United States were "primarily concerned with the trade and shipping rights of individuals" and became "outmoded" "as corporate involvement in international trade expanded in this century". *Sumitomo*, 457 U.S. at 186 & n.14.

particular, SPNV has contended that Article XI, ¶ 4 of the United States-Netherlands FCN Treaty adopts the internationally accepted method of arm's-length accounting and prohibits the use of "upstream" unitary tax methods on a Netherlands parent and its American subsidiaries. *Id.* at 15-18.<sup>14</sup> Numerous other FCN Treaties have comparable provisions.

If that treaty interpretation is correct—and numerous foreign governments have supported SPNV as amici in that view<sup>15</sup>—then a foreign parent should have standing to assert violations of its substantive treaty rights. *See generally* Note, *Standing Under Commercial Treaties: Foreign Holding Companies and the Unitary Tax*, 97 Harv. L. Rev. 1894 (1984). This standing argument is strengthened by the fact that most, though perhaps not all, American subsidiaries of foreign parents accorded rights pursuant to FCN Treaties lack standing to prosecute claims pursuant to those treaties in federal court. *Sumitomo*, 457 U.S. at 182-83, 185 n.12.

The Ninth Circuit has disagreed with SPNV's treaty interpretation, at least with regard to the standing issue, and has held that the rights granted to foreign corporations pursuant to FCN Treaties are limited to the right "to conduct business in [the United States] on a comparable basis with domestic firms". *Shell Petroleum N.V. v. Graves*, 709 F.2d at 596 (quoting *Sumitomo*, 457 U.S. at 185-86). However, even if this limitation is correct—and SPNV submits, and the Netherlands government has agreed,<sup>16</sup> that it is not—the right as

<sup>14</sup> Excerpts from the United States-Netherlands FCN Treaty, 8 U.S.T. 2043, T.I.A.S. No. 3942, are reprinted in the appendix to this brief.

<sup>15</sup> *See* Motion for Leave to File Brief and Brief of the Governments of Belgium, Denmark, France, The Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, and the United Kingdom (the Member States of the European Communities) as Amici Curiae, filed November 10, 1983, *Shell Petroleum N.V. v. Franchetti*, No. 83-586.

<sup>16</sup> *See* Brief of the Government of the Kingdom of The Netherlands as Amicus Curiae, filed October 17, 1983, *Shell Petroleum N.V. v. Franchetti*, No. 83-586.

defined by the Ninth Circuit would be violated by the denial of standing to a foreign holding company parent (such as SPNV) to pursue the type of partial remedy available to a domestic holding company parent suffering a double taxation injury arising out of the "upstream" application of a unitary tax method. See pp. 14-16 *supra*.

As noted above, respondents here do not assert a claim under a post-war FCN Treaty, and therefore they cannot claim standing pursuant to such a treaty. SPNV raises the issue here simply to apprise the Court of this additional basis for standing which will be available to many foreign parent companies. Resolution of the issue of standing to raise exclusively constitutional claims, even if that issue is resolved contrary to respondents, should not foreclose the possibility that a foreign parent company has standing to raise treaty claims, including national treatment claims that incorporate constitutional analyses of the double taxation problem.

**D. The Need for Federal Uniformity Regarding Taxation of Instrumentalities of Foreign Commerce Also Supports a Finding of Standing.**

Article I, § 8, cl. 3 of the United States Constitution vests in the federal government the power to regulate foreign commerce. In both *Container*, 463 U.S. at 186, and *Japan Line*, 441 U.S. at 448-51, this Court has recognized that the federal government's need to speak with one voice concerning matters of foreign commerce contributes to the heightened level of scrutiny necessary when analyzing the international application of an apportioned tax.

The United States and every other significant trading nation in the world tax foreign corporations doing business within their territorial jurisdictions through a local subsidiary by treating the local subsidiary as an independent entity, determining the subsidiary's income on the basis of its separate accounts and looking to the foreign parent's accounts only when necessary to adjust transactions between parent and subsidiary to arm's-length values. See generally *Container*, 463 U.S. at 184-85; *id.* at 198 (Powell, J., dissenting). This approach,

commonly referred to as the arm's-length method, has not only been universally followed, but has also been adopted in numerous bilateral treaties, including post-war FCN Treaties. Petitioners' "upstream" application of a formula-apportioned income tax to the combined income of a foreign parent company and its worldwide subsidiaries is in sharp conflict with this internationally accepted norm.

The need for federal uniformity in conducting foreign affairs is particularly apparent when differing state and federal policies toward foreign countries prompt international protest, creating the potential for retaliation against the nation as a whole, not just against the state posing the conflict. *Japan Line*, 441 U.S. at 450. Such a threat of retaliation is particularly pronounced where, as here, state officials are acting against a foreign parent company, because the interest of a foreign government in protecting the legitimate rights of its nationals is strongest in such a case. The burden California's "upstream" unitary tax imposes on foreign parent companies greatly offends other nations and threatens to elicit retaliatory measures. See Brief Amicus Curiae of the United States, dated March 6, 1986, filed before the District Court in *Alcan*, at 23. Purely prudential concerns regarding standing should not act as a bar to the swift resolution of this important matter, which is preventing the federal government from assuring uniformity in an aspect of foreign commerce of great concern to many of its trading partners.

**E. The Application of a Unitary Tax "Upstream" to a Foreign Parent Presents Special Problems Not Previously Addressed by the Court in Its Review of "Downstream" Applications of a Unitary Tax, And Those Problems Further Support a Finding of Standing.**

In a line of cases reaching back to the early part of this century, this Court has progressively reviewed various aspects of the application of unitary tax methods and drawn boundaries between those that can survive constitutional challenge and

those that cannot.<sup>17</sup> In *Container*, the Court specifically addressed the international application of a unitary tax formula. While the Court upheld the "downstream" international application of the California unitary tax in *Container*, the same analysis, applied in the "upstream" international context, indicates that double taxation occurs to a greater degree in the "upstream" context.<sup>18</sup>

In *Container*, the domestic parent taxpayer attacked California's three factor (payroll, property and sales) apportionment formula on the related grounds that the formula, by ignoring the greater profitability of foreign subsidiaries, distorts the true allocation of income and that greater domestic costs of production unfairly inflate the ratio of income apportioned to the domestic operations. This Court responded by stating that

<sup>17</sup> See, e.g., *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983) (upholding the constitutionality of the California unitary tax as applied "downstream" to a Delaware parent with foreign subsidiaries); *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207 (1980) (holding that the Due Process Clause of the Fourteenth Amendment and the Commerce Clause do not bar the application of the Wisconsin unitary tax to a Delaware corporation doing business in Wisconsin); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980) (holding that the Due Process Clause and the Commerce Clause do not bar the inclusion of "foreign source" dividend income in the taxable income subject to the Vermont unitary tax). See also *Shell Oil Co. v. Iowa Dep't of Revenue*, 109 S. Ct. 278 (1988); *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982); *F.W. Woolworth Co. v. Taxation & Revenue Dep't*, 458 U.S. 354 (1982); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978); *General Motors Corp. v. Washington*, 377 U.S. 436 (1964); *Butler Bros. v. McCollgan*, 315 U.S. 501 (1942); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271 (1924); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920).

<sup>18</sup> Petitioners allege that the Seventh Circuit improperly considered the merits of respondents' claims in deciding the standing issue. FTB Brief at 33-34. The Seventh Circuit clearly left consideration of the merits to the district court. *Alcan*, 860 F.2d at 697 n.10. The Seventh Circuit's statement that "the potential for constitutionally significant offense is sufficient to create standing" is entirely within the bounds of this Court's statement that standing "often turns on the nature and source of the claim asserted". *Warth*, 422 U.S. at 500.

the proposed alternative (arm's-length accounting) "'may fail to account for contributions to [the foreign subsidiaries'] income resulting from functional integration, centralization of management, and economies of scale'". 463 U.S. at 181 (quoting *Mobil*, 445 U.S. at 438). The assumption underlying the Court's "economies of scale" analysis is that a parent company performs certain functions on behalf of its subsidiaries because the cost of those functions to the parent is less than it would be to the subsidiaries. This relieves the subsidiaries of at least some of the costs associated with those functions, thereby increasing their profitability. Thus, the parent's contribution to the subsidiaries' profitability is presented as a justification for attributing a portion of the subsidiaries' income to the parent.

However, arguments such as "economies of scale" cannot be used to mitigate the risk of double taxation when a unitary tax formula is applied "upstream" from an American subsidiary to a foreign parent. Any economies achieved by such integration or centralization should already be reflected as an increase in the income of the American subsidiary and therefore cannot be used as a justification for capturing some portion of the foreign parent's income and attributing it to the subsidiary. It was the recognition of the greater problem presented by "upstream" international application of a unitary tax that prompted Justice Powell to state in his *Container* dissent:

"The Court's argument is even more difficult to accept when one considers the dilemma it creates for cases involving foreign corporations. If California attempts to tax the American subsidiary of an overseas company on the basis of the parent's worldwide income, with the result that double taxation occurs, I see no acceptable solution to the problem created. Most of the Court's analysis is inapplicable to such a case. There can be little doubt that the parent's government would be offended by the State's action and that international disputes, or even retaliation against American corporations, might be expected. It thus seems inevitable that the tax would have to be found unconstitutional at least to the extent it is applied to foreign companies." 463 U.S. at 202-03 (emphasis supplied; footnote omitted).

In addition, the three factors used by the Court in *Container* to distinguish *Japan Line* carry less weight when a unitary tax formula is being applied "upstream" to a foreign parent. In *Japan Line*, this Court held that California's application of an apportioned value added property tax to Japanese shipping containers subject to full taxation in Japan was unconstitutional under the Commerce Clause. 441 U.S. at 453-54. In *Container*, the Court conceded that "[t]he case most relevant to [its] inquiry" regarding "the additional scrutiny required by the Foreign Commerce Clause" when applying a unitary tax to an international enterprise (in that case headed by a domestic parent) is *Japan Line*, 463 U.S. at 185.

In distinguishing *Japan Line* and holding that "downstream" international application of a unitary tax is not barred by the Foreign Commerce Clause, the Court relied upon three factors. *Id.* at 187-89. The first, that *Japan Line* involves a tax on property rather than income, applies in the instant case but is by no means dispositive, just as it was not dispositive in *Container*. The second, that "the double taxation in this case, although real, is not the 'inevitabl[e]' result of the California taxing scheme", *id.* at 188, carries significantly less weight when (as here) a unitary tax is being applied "upstream", because the factors mitigating double taxation in the "downstream" context are not present. *See pp. 19-21 supra; see also Container*, 463 U.S. at 202-03 (Powell, J., dissenting).<sup>19</sup> Finally, the third factor, that "the tax here falls, not on the foreign owners of an instrumentality of foreign commerce, but on a corporation domiciled and headquartered in the United States", 463 U.S. at 188, is clearly inapplicable in the present context.

The "upstream" application of a unitary tax formula imposes a substantial risk of unremedied double taxation on a

<sup>19</sup> The increased risk of double taxation is underscored by the fact that "the taxing authorities of the United Kingdom consider the California [unitary] taxes to be partially measured by income not having a source in California" and therefore do not permit full credit for California taxes as "foreign taxes paid on earnings which are the source of dividends paid to a U.K. company". FTB Brief at 38.

foreign parent choosing a corporate subsidiary as its instrument of foreign commerce that is significantly greater than the risk faced by an American parent making the same choice. This direct and increased injury of double taxation impermissibly burdens a foreign parent's choice of the manner in which it participates in foreign commerce. The independent and direct nature of that injury to the foreign parent company should be more than sufficient to grant that foreign parent standing to challenge an "upstream" unitary tax formula pursuant to the Foreign Commerce Clause.

## II. Neither the Tax Injunction Act Nor the Principle of Comity Underlying It Bars Suit in Federal Court by a Foreign Parent.

The Tax Injunction Act of 1937, 28 U.S.C. § 1341, provides:

"The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."

Since a foreign parent company has no "plain, speedy and efficient remedy" in the California state courts, the Act, by its own terms, is inapplicable.

State judicial and administrative remedies are available only to the party that California deems to be the nominal taxpayer. Despite the fact that it is the foreign parent that is suffering the injury of double taxation, *see pp. 7-9 supra*, and that California ignores corporate form in defining an "upstream" unitary business of which the foreign parent is the head, *see pp. 11-12 supra*, California chooses not to recognize the parent as a taxpayer. *See Capitol Industries-EMI, Inc. v. Bennett*, 681 F.2d 1107, 1118 (9th Cir.), *cert. denied*, 455 U.S. 943 (1982). Since the foreign parent is not granted taxpayer status, it has no state remedy whatsoever, much less a "plain, speedy and efficient" one. *General Motors Corp. v. California State Board of Equalization*, 815 F.2d 1305, 1308 (9th Cir. 1987) (Kennedy, J.); *Capitol Industries-EMI*, 681 F.2d at 1118.

Consistent with the plain language of the statute, the lower courts have held § 1341 inapplicable where an injured foreign parent company has no state remedy. In *General Motors*, Judge (now Justice) Kennedy stated that "[t]he Tax Injunction Act is no bar to [a party's] suit" where the party had "no remedy in [California] state court". 815 F.2d at 1308.<sup>20</sup> Nor does the Tax Injunction Act preclude an injured party's action for redress simply because another party may be entitled to bring its own action in state court:

"No authority has been presented for the proposition that a nontaxpayer, without state administrative or judicial remedies, is precluded under Section 1341 from maintaining an action in federal court because it has substantially similar interests and claims as a taxpayer that has such state remedies. A nontaxpayer that has stated a claim with respect to an assessment or collection is entitled to a judicial remedy in which they [sic] can participate as a party." *Capitol Industries-EMI*, 681 F.2d at 1119.

<sup>20</sup> See also *Builders and Developers Corp. v. Manassas Iron and Steel Co.*, 208 F. Supp. 485, 491 (D. Md. 1962); *Alcan I*, 558 F. Supp. at 626 (citing *Alcan Aluminium Ltd. v. Franchise Tax Board*, 539 F. Supp. 512, 514-15 (S.D.N.Y. 1982)). But cf. *Shell Petroleum N.V. v. Graves*, 709 F.2d at 596-97 (affirming the decision of the district court that the policies underlying the Tax Injunction Act compelled a finding that a suit in federal court by the foreign parent company was not ripe where the domestic subsidiaries had an available state court remedy).

Petitioners' argument—that both the Tax Injunction Act and its underlying principle of comity bar an action by a foreign parent where a domestic subsidiary has available a remedy in the state courts, FTB Brief at 41-50—runs contrary to both the weight of the cited precedent and the legislative history of the Act, see p. 25 *infra*. Moreover, arguing that the subsidiary should sue on the double taxation claims of the foreign parent company flies in the face of the central tenet of the standing inquiry: the party directly injured and best able to place the issues before the court should be the one to litigate the claim. There is nothing in the Tax Injunction Act or its legislative history to suggest that the Act was intended to create a different standing doctrine for state tax cases.

Since respondents—and other, similarly situated foreign parent companies—have no state remedy, the Tax Injunction Act is inapplicable.<sup>21</sup>

The legislative history of the Tax Injunction Act supports this conclusion. The Act was specifically intended not to foreclose completely an injured party's access to judicial relief. The report of the Senate Judiciary Committee in support of the Act stated that:

"[T]he bill does not take away any equitable right of the taxpayer or deprive him of his day in court. Specific provision is made that the suit will not be withdrawn from the jurisdiction of the Federal district court except where there is a plain, speedy, and efficient remedy at law or in equity in the courts of the State. *A full hearing and judicial determination of the controversy is assured.*" S. Rep. No. 1035, 75th Cong., 1st Sess. 2 (1937) (emphasis supplied).

See also 81 Cong. Rec. 1416 (1937) (remarks of Sen. Bone). The legislative history is entirely consistent with the judicial interpretation of the Tax Injunction Act as being inapplicable where there is no state forum available for an injured foreign parent company.

Similarly, the principle of comity underlying the Tax Injunction Act does not justify the denial of a federal forum to a foreign parent. The standard governing the application of the principle of comity in an action such as this, challenging the constitutionality of a state tax statute as applied, is the same as the standard governing the application of the Act itself: does the plaintiff have available a plain, speedy and efficient remedy in state court? See *Fair Assessment in Real Estate Ass'n, Inc. v.*

<sup>21</sup> The Court's opinion in *Fair Assessment in Real Estate Ass'n, Inc. v. McNary*, 454 U.S. 100 (1981), is not to the contrary. In that case, the Court held that the nonexhaustion rule of 42 U.S.C. § 1983 did not override the Tax Injunction Act, and that a taxpayer with plain, speedy and adequate state remedies was therefore barred from bringing a federal action under § 1983. *Id.* at 116. As the Seventh Circuit correctly noted, the foreign parent company in an action such as the present one has no state remedy at all, so *Fair Assessment* is inapplicable. 860 F.2d at 699.

*McNary*, 454 U.S. 100, 116 & n.8 (1981). Where, as here, the foreign parent has *no* remedy in the state courts, abstention would clearly be improper. Congressional intent not to foreclose access to the federal courts where no adequate state relief is available should not be frustrated in the name of comity.

There is an additional reason not to apply the Tax Injunction Act or its underlying principle of comity where, unlike respondents here, the foreign parent is a company of a country which has entered into an FCN Treaty with the United States. As discussed above, FCN Treaties confer specific substantive rights and protections on foreign corporations. See pp. 16-18 *supra*. Accompanying those substantive rights are procedural rights of access to American courts, without which the substantive rights could be rendered meaningless. See, e.g., Treaty of Friendship, Commerce and Navigation between the United States of America and the Kingdom of The Netherlands, March 27, 1956, Article V, ¶ 1. Federal statutes, including the Tax Injunction Act, should be construed so as to render them compatible with United States treaties. See Restatement (Second) of the Foreign Relations Law of the United States § 145 comment b & reporter's note 1 (1965). Since a foreign parent company cannot assert its treaty claims in a California state court, neither the Tax Injunction Act nor its underlying principle of comity should be applied to deny a foreign parent its only available forum, the federal court.

### CONCLUSION

The foreign parent company of an American subsidiary has standing in federal court to challenge, under the Foreign Commerce Clause, the application of a state unitary business tax to the "upstream" combination of the income of the nominal taxpayer subsidiary, its foreign parent and the worldwide subsidiaries and affiliates of that parent. Neither the Tax Injunction Act nor the principle of comity underlying that Act bars such suit.

In any event, due to the special policy considerations applicable to the taxation of foreign companies under the Constitution, and the rights and protections accorded various foreign companies by United States treaties and international conventions, this Court should not decide the case before it on grounds that would foreclose a foreign parent company from raising claims that the "upstream" application of a unitary tax to a foreign parent and its worldwide subsidiaries and affiliates violates United States treaties and general principles of international law.

Respectfully submitted,

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July 7, 1989

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## **APPENDIX**

**Excerpts from the  
Treaty of Friendship, Commerce and Navigation  
between the  
United States of America  
and the  
Kingdom of The Netherlands  
[8 U.S.T. 2043, T.I.A.S. No. 3942]**

**Treaty, with protocol and exchange of notes, signed at  
The Hague March 27, 1956;**

**Entered into force December 5, 1957.**

\* \* \*

**Article I**

1. Each Party shall at all times accord fair and equitable treatment to the nationals and companies of the other Party, and to their property, enterprises and other interests.

2. Between the territories of the two Parties there shall be, in accordance with the provisions of the present Treaty, freedom of commerce and navigation.

\* \* \*

**Article V**

1. Nationals and companies of either Party shall be accorded national treatment with respect to access to the courts of justice and to administrative tribunals and agencies within the territories of the other Party, in all degrees of jurisdiction, both in pursuit and in defense of their rights. It is understood

that companies of either Party not engaged in activities within the territories of the other Party shall enjoy such access therein without any requirement of registration or domestication.

\* \* \*

#### Article VI

\* \* \*

3. Neither Party shall take unreasonable or discriminatory measures that would impair the rights or interests within its territories of nationals and companies of the other Party, whether in their capital, or in their enterprises and the property thereof, or in the skills, arts or technology which they have supplied.

\* \* \*

#### Article VII

1. Nationals and companies of either Party shall be accorded national treatment with respect to engaging in all types of commercial, industrial, financial and other activity for gain (business activities) within the territories of the other Party, whether directly or by agent or through the medium of any form of lawful juridical entity. Accordingly, such nationals and companies shall be permitted within such territories: (a) to establish and maintain branches, agencies, offices, factories and other establishments appropriate to the conduct of their business; (b) either directly or indirectly through one or more intermediaries, to organize companies under the general company laws of such other Party and to acquire the controlling interest in companies of such other Party; (c) to control and

manage enterprises which they have established or acquired. Moreover, enterprises which they control, whether in the form of individual proprietorships, companies or otherwise, shall in all that relates to the conduct of the activities thereof, be accorded treatment no less favorable than that accorded like enterprises controlled by nationals and companies of such other Party.

\* \* \*

#### Article XI

1. Nationals of either Party residing within the territories of the other Party, and nationals and companies of either Party engaged in trade or other gainful pursuit or in scientific, educational, religious or philanthropic activities within the territories of the other Party, shall not be subject to the payment of taxes, fees or charges imposed upon or applied to income, capital, transactions, activities or any other object, or to requirements with respect to the levy and collection thereof, within the territories of such other Party, more burdensome than those borne by nationals and companies of such other Party.

2. With respect to nationals of either Party who are neither resident nor engaged in trade or other gainful pursuit within the territories of the other Party, and with respect to companies of either Party which are not engaged in trade or other gainful pursuit within the territories of the other Party, it shall be the aim of such other Party to apply in general the principle set forth in paragraph 1 of the present Article.

3. Nationals and companies of either Party shall in no case be subject, within the territories of the other Party, to the payment of taxes, fees or charges imposed upon or applied to income, capital, transactions, activities or any other object, or to requirements with respect to the levy and collection thereof, more burdensome than those borne by nationals, residents and companies of any third country.

4. In the case of companies and of non-resident nationals of either Party engaged in trade or other gainful pursuit within

the territories of the other Party, such other Party shall not impose or apply any tax, fee or charge upon any income, capital or other basis in excess of that reasonably allocable or apportionable to its territories, nor grant deductions and exemptions less than those reasonably allocable or apportionable to its territories. A comparable rule shall apply also in the case of companies organized and operated exclusively for scientific, educational, religious or philanthropic purposes.

5. Each Party reserves the right to: (a) extend specific tax advantages on the basis of reciprocity; (b) accord special tax advantages by virtue of agreements for the avoidance of double taxation or the mutual protection of revenue; and (c) accord to its own nationals and to residents of contiguous countries more favorable exemptions of a personal nature with respect to income and inheritance taxes than are accorded to other non-resident persons.

\* \* \*

### Article XXIII

1. The term "national treatment" means treatment accorded within the territories of a Party upon terms no less favorable than the treatment accorded therein, in like situations, to nationals, companies, products, vessels or other objects, as the case may be, of such Party.

2. The term "most-favored-nation treatment" means treatment accorded within the territories of a Party upon terms no less favorable than the treatment accorded therein, in like situations, to nationals, companies, products, vessels or other objects, as the case may be, of any third country.

3. As used in the present Treaty, the term "companies" means corporations, partnerships, companies, foundations, associations, and other legal entities or juridical persons, whether or not with limited liability and whether or not for pecuniary profit. Companies constituted under the applicable laws and regulations within the territories of either Party shall

be deemed companies thereof and shall have their juridical status recognized within the territories of the other Party.

4. National treatment accorded under the provisions of the present Treaty to companies shall: (a) as regards companies of the Kingdom of the Netherlands, in any State, Territory or possession of the United States of America, be the treatment accorded therein to companies created or organized in other States, Territories and possessions of the United States of America; and (b) as regards companies of the United States of America, in any Part of the Kingdom of the Netherlands, be the treatment accorded therein to companies created or organized in any other Part of the Kingdom. Furthermore, in any Part of the Kingdom of the Netherlands outside Europe, national treatment accorded to nationals of the United States of America shall be the treatment accorded in such Part to Netherlands nationals not born in that Part.

\* \* \*

JUL 17 1989

JOSEPH F. SPANIO  
CLERK

IN THE  
**Supreme Court of the United States**  
OCTOBER TERM, 1989

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA;  
LEONARD WILSON, Individually and as District Man-  
ager, Chicago Office of the Franchise Tax Board of the  
State of California; and B. M. RARANG, Individually  
and as Auditor, Chicago Office of the Franchise Tax  
Board of the State of California,

*Petitioners,*  
v.

ALCAN ALUMINIUM LIMITED and  
IMPERIAL CHEMICAL INDUSTRIES PLC,  
*Respondents.*

On Writ of Certiorari to the  
United States Court of Appeals  
for the Seventh Circuit

BRIEF OF THE  
COMMITTEE ON STATE TAXATION OF THE  
COUNCIL OF STATE CHAMBERS OF COMMERCE  
AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

PAUL H. FRANKEL \*

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Co-Chairmen, Lawyers'  
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IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1989

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No. 88-1400

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FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA;  
LEONARD WILSON, Individually and as District Man-  
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On Writ of Certiorari to the  
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BRIEF OF THE  
COMMITTEE ON STATE TAXATION OF THE  
COUNCIL OF STATE CHAMBERS OF COMMERCE  
AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

---

INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State  
Taxation of the Council of State Chambers of Commerce  
as *amicus curiae* in support of respondents in the above-

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captioned case. Written consents of the Petitioners and the Respondents have been obtained and are attached herewith.

### INTEREST OF *AMICUS CURIAE*

This brief in support of Respondents Alcan Aluminium Limited and Imperial Chemical Industries is submitted by the Committee on State Taxation (COST) of the Council of State Chambers of Commerce. The Council of State Chambers of Commerce (Council), organized in 1932, consists of 43 state chambers of commerce. COST, one of three advisory committees of the Council, consists of 315 corporate members which conduct a substantial portion of the interstate and foreign commerce of United States taxpayers. The majority of COST members are American parent companies. COST is primarily involved in working with states and others to achieve equitable standards of state taxation. Because of the potential for retaliatory legislation by foreign nations to permit the use of unitary taxation which will have a severe negative impact upon American parent companies operating abroad, COST vehemently opposes California's forced application of the Worldwide Method of Combined Apportionment (WCA).

Member firms of COST invest heavily in overseas markets. This is required by the modern business environment. In order to remain economically viable, companies must gain access to needed supplies of resources, and tap the potential of relevant markets. In many cases, the fact that competitors are engaged in international trade requires firms to expand their markets.

The imposition of WCA is functionally equivalent to erecting a barrier to free trade among nations. WCA not only assesses revenues earned inside the forum but also revenues earned outside the forum; indeed if WCA were adopted by all nations it would create a huge and unacceptable cost of doing business. It should be no sur-

prise, therefore, that California's use of WCA is offensive to America's foreign trading partners.<sup>1</sup>

COST harbors no doubt if WCA is required that retaliatory legislation by foreign nations will be implemented and will adversely impact its member firms. It will alter the way in which business decisions are made to the detriment of the world's economy. Rather than looking at market considerations, companies will be stymied by the tax ramifications of intended actions. Such an environment is bad for business, bad for trade and bad for consumers.

Foreign governments cannot be expected to give double tax relief to their own nationals for taxes that are imposed by California on income that is not sourced in California. As a result, retaliation may be expected to take the form of denying tax relief to U.S. businesses. *See*, N.C. 27 Finance Act of 1985, as enacted by the United Kingdom Parliament.

In a business climate controlled by the retaliatory WCA tax policies of foreign nations, it is the parent and not the subsidiary which bears the impact of the tax.

Respondents are before this Court as foreign parents with American subsidiaries. If they are not permitted a

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<sup>1</sup> As the Seventh Circuit noted in pertinent part: "To the extent that California's franchise tax burdens foreign companies' decisions to conduct business through subsidiaries in California, it threatens to offend this Country's trading partners, many of whom must deal with conflicting internal views of the proper role of American investment in their economies, and to elicit retaliatory measures. . . . The record in this case contains numerous indications that foreign governments view California's and other states' sharp departures from the international norm of taxing corporate income based on transactional allocations of income as a source of serious injury to multinationals located within their borders and a threat to commercial relations with the United States." *Alcan Aluminium Ltd. v. Franchise Tax Board*, No. 87-2289 (7th Cir., 1988), *Imperial Chemical Industries, PLC v. Franchise Tax Board*, No. 87-2295, Slip Op. at 21 (7th Cir. 1988).

remedy to object to WCA, it is only a brief matter of time before American companies will see themselves in the same position in a foreign tribunal. In such a situation, a United States parent corporation would demand the right to represent its' own case to the foreign tribunal. We expect that the United States would afford nothing less than our expectation to foreign corporations with American subsidiaries.

### STATEMENTS OF FACT

*Amicus* adopts the Statement of the Case set forth in Respondents' Briefs on the Merits.

### SUMMARY OF ARGUMENT

This case presents an issue of major importance for all multinational corporations, both foreign and domestic. The Worldwide Method of forced Combined Apportionment utilized by the State of California is a system of taxation which threatens the conduct of international trade. Threatened retaliatory legislation by foreign nations places American companies with overseas subsidiaries in a position identical to that which faces Respondents.

*Amicus* urges that Respondents be permitted to present their complaint before the Federal District Court for the very reasons that American parent companies in the position of Respondents would seek to be heard before foreign tribunals. It is the parent company, not the foreign subsidiary acting as a surrogate, which can most clearly and precisely state its grievance to the court.

### ARGUMENT

#### THE NATURE OF FORCED WORLDWIDE COMBINED APPORTIONMENT MAKES ITS INJURY FELT BY THE PARENT COMPANY.

Little more than a century ago, American trade wars were fought from an interstate perspective. Today, we deal from a world economic viewpoint in which America is only one marketplace. In numerous areas, a corporation's viability depends on its capacity to enter and serve markets outside the United States. In some cases, the fixed costs of production are so high that in order to make a commodity affordable to consumers, it must be produced in mass quantity and distributed across a huge population. Raw materials necessary for production may be available only in certain locations, or only limited quantities of the material may be found in any one area. In such cases, engaging in foreign activity may be required just to stay in business. Likewise, it may be necessary to find new avenues for product distribution as old markets become saturated.

There are any number of reasons for operating in foreign countries. However, one thing is clear, as the world's economy continues to grow, participation in foreign commerce is becoming compulsory. This is true for both foreign companies with American subsidiaries and American companies with foreign subsidiaries. The era of isolationism has long passed and companies cannot expect to survive by operating in the past.

The difficulty with California's use of WCA is that it is inconsistent with the agreement reached between nations for the ordered conduct of foreign commerce. There are sound reasons for using the arm's length standard. First, formula apportionment, by its nature, tends to favor one economic environment over another. Consequently, there could be no international agreement on a common formula. Second, the arm's length standard is based on marketplace value and the marketplace is beyond the manipulation of any one nation.

Moreover, the arms' length standard does not require multinationals to keep burdensome accounting records in various systems and currencies. As Americans, we sometimes tend to ignore the costs being imposed by our actions on our foreign neighbors. If WCA was imposed on us by foreign nations, we would suffer enormous burdens. For example, under a system of unitary taxation, suppliers in Atlanta, Georgia, or manufacturers in Muncie, Indiana, with subsidiaries in perhaps 100 foreign markets would find themselves subject to not only state and federal taxes on their earnings in the United States, but also to a range of tax liability permutations, such as paying Japanese taxes on their United States, West German and Italian income. This problem expands geometrically when one considers that the difficulties of compliance are multiplied under WCA as each of the 100 nations in which the Atlanta and Muncie-based companies in this example operates uses different apportionment factors in their tax computations. Naturally, the nations will choose those factors which provide the most revenue. For example, where labor is cheap, work-hours could be a factor, and where labor is expensive, payroll could be a factor; where real estate is expensive, property could be a factor. India could consider factors relevant which Japan may find useless.

American companies will be forced to spend thousands of hours and millions of dollars developing accounting systems to comply with the individual reporting requirements. Just to serve their overseas markets, the American companies will be required to develop the capacity to translate all of their records into the currency of each country in which it has a subsidiary, and then break down those records according to different mathematical formulae. The administrative costs alone would be staggering, but the problem is exacerbated by the high likelihood that the American companies would face a crisis of multiple taxation. American corporations no longer would seek to expand their operations by exploiting markets

for their commercial potential; rather, their business decisions would be motivated in large measure by the tax consequences.

American-based parent corporations expect United States courts to recognize foreign parents' rights to seek vindication of their injury here as they would expect foreign courts to recognize their right to bring an action should WCA be imposed upon them by a foreign country. If this Court decides that the foreign parent does not have standing, it will severely prejudice the ability of United States based parents seeking to complain of similar injuries in foreign courts.

### CONCLUSION

California's forced use of WCA has directly injured Respondents. Respondents seek redress in federal court because they do not have access to a state court remedy. Respondents currently face a situation which soon may confront American corporations with foreign subsidiaries.

What the Court decides in this case will affect the treatment of American companies with subsidiaries abroad. Judgment should be entered in favor of the Respondents, affirming the view of the Seventh Circuit.

Respectfully submitted,

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No. 88-1400

Supreme Court, U.S.

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CLERK

IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1989

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA;  
LEONARD WILSON, Individually and as District Man-  
ager, Chicago Office of the Franchise Tax Board of the  
State of California; and B.M. RARANG, Individually  
and as Auditor, Chicago Office of the Franchise Tax  
Board of the State of California,

v.

*Petitioners,*

ALCAN ALUMINIUM LIMITED and  
IMPERIAL CHEMICAL INDUSTRIES, PLC,

*Respondents.*

On Writ of Certiorari to the United States  
Court of Appeals for the Seventh Circuit

BRIEF OF THE GOVERNMENT OF CANADA  
AS AMICUS CURIAE SUPPORTING RESPONDENTS

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BRIEF OF THE GOVERNMENT OF CANADA  
AS AMICUS CURIAE SUPPORTING RESPONDENTS

---

**INTEREST OF AMICUS CURIAE**

The United States and Canada exchange more goods,  
services and capital than any other two countries in the  
world. Trade between Canada and the state of California  
is sizable.

The basis upon which the United States and Canada,  
as well as the international community of nations, avoid  
double taxation of their corporate citizens is through the

use of the internationally accepted method of corporate tax assessment, the arm's length or separate accounting method ("AL/SA").<sup>1</sup> Political subdivisions of federal states (province, states, cantons, landers) when exercising their own taxing powers, respect AL/SA as reflecting a norm accepted in insuring a proper balance between taxing requirements and the legitimate conduct of commercial activities by multinational enterprises ("MNEs"). All Canadian provinces apply that method. California instead relies upon a conflicting method, worldwide combined reporting ("WWCR"). Only three other states in the United States also use WWCR.

Respondent Alcan Aluminium Limited ("Alcan") is a Canadian corporation with a United States subsidiary. Neither Alcan nor any of its other foreign subsidiaries do business or has a permanent establishment in the United States. Nevertheless, California's use of WWCR burdens Alcan directly in its foreign commerce and interferes with the trade and business relations between Canada and the United States. This Court has specifically left unanswered the question of the constitutional validity of the application to and effect of WWCR on foreign parent corporations like Alcan with American subsidiaries.<sup>2</sup>

This case raises the issue of whether Alcan has standing in Federal courts. This petition stems from a decision of the Seventh Circuit Court of Appeals recognizing Alcan's standing in Federal courts for the purpose of challenging California's application of WWCR. Canada presents this *Amicus Curiae* brief because denial of standing would amount to a denial of fundamental judicial remedies to Alcan. Canada has a sovereign interest in its corporate citizens being permitted to defend their

<sup>1</sup> The Convention Between the United States of America and Canada with Respect to Taxes on Income and Capital, 1 Tax Treaties (CCH) 1371MB.

<sup>2</sup> *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983).

rights in a foreign jurisdiction. Denial of standing would furthermore result in a failure by U.S. courts to determine issues vital to trade and fiscal policy between sovereign nations, issues that have been addressed and are now well settled at international law. The ability to address the substantive issues pertaining to international taxation stands or falls on the decision of this Court regarding Alcan's standing. The Government of Canada hereby submits this brief *amicus curiae* in support of Respondents.<sup>3</sup>

### SUMMARY OF ARGUMENT

Alcan should have standing in Federal courts to contest California's application of WWCR because:

- (1) WWCR disrupts the internationally accepted tax framework established between sovereign nations and creates a substantial risk of international multiple taxation; and
- (2) California's application of WWCR burdens foreign commerce and affects the U.S. government's ability to speak with one voice to foreign nations on these matters.

The application by California of WWCR to a corporate citizen of Canada results in direct injury to Alcan. Alcan has no access to state judicial or administrative remedies to contest California's application of WWCR. If Alcan is denied standing, the inextricably linked substantive issues that the application of WWCR raises will be effectively decided, because it is Alcan and not its subsidiaries that are implicated in the burden imposed on foreign commerce.

<sup>3</sup> Petitioners and Respondents have consented to the filing of this brief *amicus curiae* in letters filed with the Clerk of this Court.

## ARGUMENT

### I. Worldwide combined reporting is incompatible with agreed principles of international taxation.

The rapid growth of MNEs since World War II has resulted in problems of allocating fairly between different jurisdictions the right to tax income earned by such MNEs. To encourage trade and profitability of MNEs, many of which are U.S. based, nations have agreed to establish rules that would create a clear fiscal landscape at the international level. This international order in taxation rests on the application of AL/SA by all taxing jurisdictions.

Under AL/SA, corporations are subject to tax only by the jurisdiction in which they operate and only on that portion of their income attributable to the business carried on in that jurisdiction. Profits are subsequently taxable when distributed as dividends in those jurisdictions where the dividends are received for tax purposes. The AL/SA method has been adopted by the United Nations<sup>4</sup> and the Organization for Economic Cooperation and Development ("OECD").<sup>5</sup> The OECD Draft Model Double Taxation Agreement ensures that the right to tax activities of MNEs is equitably distributed between nations. This OECD Model is followed by the United States and Canada, as well as by the Western world and serves as the basis for all modern double taxation treaties between nations. AL/SA is embodied in the Internal

<sup>4</sup> United Nations Model Double Taxation Convention Between Developed and Developing Countries, arts. 5(8), 7(2), 9(1), U.N. Doc. ST/WSA/102 (1980).

<sup>5</sup> Report of the OECD Committee on Fiscal Affairs, Model Double Taxation Convention for Income, and on Capital, arts. 5(7), 7(2), 9(1) (1977).

Revenue Code,<sup>6</sup> and is the "clearly expressed policy of the United States."<sup>7</sup>

California, through the use of WWCR, combines the profits of related but separate corporations worldwide and taxes them on an arbitrary manner based on the ratio of payroll, property, and sales of the subsidiary in California to the payroll, property and sales of the entire worldwide corporate group. Separate entities, dividend flows, and sources of profitable activity are ignored. The mere presence of a domestic subsidiary owned by a foreign parent corporation subjects the foreign parent and all of its foreign subsidiaries to California's tax in direct contradiction to established international tax policy.

California's requests for worldwide financial information causes particular difficulties when the information demanded pertains to the relations between foreign corporations and foreign governments, which the latter consider confidential and which should not be released outside their particular jurisdictions. If the domestic subsidiary can not comply with Petitioners' demands, whether because of foreign law (blocking statute)<sup>8</sup> or the unavailability of the required information, the worldwide tax base may be arbitrarily determined and additional penalties for the failure to provide the information may be assessed. This extraterritorial pretension of California tax laws is a source of concern as it may displace or purport to displace sovereign policies of foreign nations.

Under AL/SA, the profitable corporations are subject to tax where the profits are made, and the less profitable

<sup>6</sup> Internal Revenue Code of 1986, as amended: 26 U.S.C. § 482,

<sup>7</sup> Brief *Amicus Curiae* of the United States, Civil Action No. 84-C-8906 United States District Court for the Northern District of Illinois, Eastern Division, p. 4; U.S. Treasury Departments Model Income Tax Treaty of June 16, 1981, arts. 5(7), 7(2), 9(1), I CCH Tax Treaties 158.

<sup>8</sup> *Foreign Extraterritorial Measures Act*, R.S.C. 1985, c.F-29 is relevant.

or unprofitable subsidiaries pay less or no tax in the jurisdictions where they conduct business. The theory underlying WWCR is that there is one worldwide level of profitability and a dollar spent on payroll or property or made in sales in one jurisdiction, produces roughly the same amount of taxable income as a dollar so spent or made in another jurisdiction.

While within the borders of the United States these assumptions may be valid, no comparable assumption can be made when dealing with a multinational corporate group with subsidiaries worldwide. This is particularly true considering the variety of economic systems (North-South, East-West) and even between Western countries where divergent economic policies still exist and require the application of a unique and accepted method of taxation, AL/SA, which constitutes the underpinnings of the network of double taxation agreements. In this context, it is worth recalling that since California is a political subdivision of the United States with no separate personality in international law, Canada does not and cannot enter into a treaty relationship with California to cover double taxation matters.

Canada has noted that this Court has expressed sensitivity to the international ramifications of state taxation of foreign commerce:

neither this Court nor this Nation can ensure full apportionment when one of the taxing entities is a foreign sovereign. If an instrumentality of commerce is domiciled abroad, the country of domicile may have the right, consistently with the custom of nations, to impose a tax on its full value. If a State should seek to tax the same instrumentality on an apportioned basis, multiple taxation inevitably results. . . . Due to the absence of an authoritative tribunal capable of ensuring that the aggregation of taxes is computed on no more than one full value, a state tax, even though 'fairly apportioned' to reflect

an instrumentality's presence within the State, may subject foreign commerce' "to the risk of a double tax burden to which [domestic] commerce is not exposed, and which the commerce clause forbids." " *Evco v. Jones*, 409 U.S., at 94, quoting *J.D. Adams Mfg. Co.*, 304 U.S. at 307, 311, 658 S. Ct. 913, 916, 82 L.Ed.1365 (1938) (footnote omitted).<sup>9</sup>

Canada, like many other Western countries, questions the utility and effectiveness of its double taxation agreement ("DTA") with the United States when the application by a few political subdivisions, such as California, of WWCR, clearly frustrates the spirit of the DTA and impairs the benefits accruing to Canadian nationals conducting commercial activities in the territory of the United States.

The Government of Canada as well as the Governments of Austria, Australia, Belgium, Denmark, France, Federal Republic of Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, the United Kingdom, and Switzerland have described the administrative burdens which result from the application of WWCR to corporations incorporated and operating in those countries.<sup>10</sup> The United States' Secretary of the Treasury has also recognized the increased burden for foreign parent corporations.<sup>11</sup>

<sup>9</sup> *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 at 447-448 (1979).

<sup>10</sup> Paper Submitted by the Government of Canada to the United States Treasury Working Group on Unitary Tax 9-10 (Nov. 30, 1983); Joint Diplomatic Note from the Embassy of Belgium to the Department of State, on behalf of Australia, Austria, Belgium, Canada, Denmark, Federal Republic of Germany, France, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, United Kingdom and Switzerland (January 25, 1984).

<sup>11</sup> "The burdens can be particularly acute for foreign-owned affiliates which are not required to keep data under U.S. tax and financial accounting rules on their non-U.S. operations for any other purposes." Letter from The Secretary of the Treasury, James

**II. Alcan has standing to challenge burdens on foreign commerce imposed by California's application of worldwide combined reporting.**

California characterizes the burden it imposes upon foreign parent corporations as being only "indirectly" incurred, arguing that they are only "shareholders" of their American subsidiaries. California, while portraying foreign parent corporations as mere "shareholders," inconsistently demands from the subsidiary financial information regarding not only the foreign parent, but the entire worldwide multi-corporate group. These demands fly in the face of a "subsidiary-shareholder" relationship. They also ignore the fact that even within corporate groups certain financial information is confidential, as between parents and subsidiaries and among subsidiaries, especially so when subsidiaries are not wholly owned. Furthermore, such information could contain trade secrets or other confidential data.

In *Container*, the incidence of tax fell upon a domestic corporation with foreign subsidiaries. This Court concluded that such taxation was of local rather than of international concern, leaving unaddressed the question of the constitutionality of California's use of WWCR to tax the income of foreign based multi-corporate groups.<sup>12</sup> The Court noted:

the fact that the legal incidence of a tax falls on a corporation whose formal corporate domicile is domestic might be less significant in a case of a domestic corporation that was owned by foreign interests.<sup>13</sup>

A. Baker, III to Representative Dan Rostenkowski, Chairman of the House of Representatives Committee on Ways and Means, March 5, 1986.

<sup>12</sup> 463 U.S. 159 at 189 n.26.

<sup>13</sup> 463 U.S. 159 at 195 n.32.

Three dissenting Justices (Powell, Burger, and O'Connor) believed that WWCR would certainly be unconstitutional if applied to a foreign parent corporation.<sup>14</sup>

In this case, the burden falls on foreign corporations, just as it did in *Japan Lines, Ltd. v. County of Los Angeles*.<sup>15</sup> Unlike the situation involving a domestic parent corporation, Petitioners' application of WWCR to foreign based multi-corporate groups inevitably leads to double taxation and is a matter of international, rather than local concern.

This Court established in *Japan Line* that even a slight overlapping of tax—a problem that might be deemed *de minimis* in a domestic context—assumes importance when sensitive matters of foreign relations and national sovereignty are concerned.<sup>16</sup> As shown above, California's use of WWCR does more than result in a slight overlapping of tax. Instead, an automatic asymmetry is created in the international tax structure when California applies WWCR to Alcan and other foreign corporations with U.S. subsidiaries. Canada, the United States and other nations do not tax the income of an MNE solely because one of its subsidiaries is domiciled in that country.

Thus California's application of WWCR to foreign based multi-corporate groups is not just another instance of income allocation, which this Court has suggested resembles "slicing a shadow."<sup>17</sup> Here California violates an established international principle, AL/SA, under which merely being a shareholder of a domestic subsidiary does not subject a foreign parent corporation and all its foreign subsidiaries to the tax of the jurisdiction in which that subsidiary does business. California's viola-

<sup>14</sup> 463 U.S. 159 at 203.

<sup>15</sup> 441 U.S. 434.

<sup>16</sup> 441 U.S. 434 at 456.

<sup>17</sup> 463 U.S. 159 at 192.

tion of that principle inevitably burdens international commerce and results in double taxation.

This asymmetry has offended Canada and other trading partners of the United States. Canada has on numerous occasions made official representations to the Federal Government regarding the conflict between WWCR and AL/SA.<sup>18</sup> The Government of Canada and the Governments of France and the United Kingdom have conveyed to the United States through a Protocol and a Note the contradiction that WWCR poses to the provisions of their double taxation treaties.<sup>19</sup> The member countries of the European Communities have on nine occasions made a *demarche*, or submitted a diplomatic note, to the United States Department of State expressing their opposition to WWCR<sup>20</sup> and have pointed out the "harm

<sup>18</sup> September 26, 1980 Exchange of Letters between Canadian Minister of Finance and the United States Secretary of the Treasury, The Convention Between the United States of America and Canada With Respect to Taxes on Income and Capital, I Tax Treaties (CCH) 1317MB; December 22, 1981 Diplomatic Note No. 692; May 10, 1982 Diplomatic Note No. 245; June 14, 1982 Diplomatic Note No. 283; August 11, 1983 Letter from Canadian Ambassador to the United States to United States Secretary of the Treasury; August 23, 1983 Letter from Canadian Ambassador to the United States to United States Secretary of the Treasury; September 24, 1983 Letter from Prime Minister Trudeau to President Reagan; September 28, 1983 Diplomatic Note No. 481; June 17, 1985 Diplomatic Note No. 338; September 30, 1987 Letter From Canadian Ambassador to the United States to the United States Secretary of State, Secretary of the Treasury, and Attorney General.

<sup>19</sup> The Convention Between the United States of America and Canada with Respect to Taxes on Income and Capital, 1 Tax Treaties (CCH) 1371MB; Protocol to the Convention with France on Income Taxes, signed Nov. 24, 1979, 2 Tax Treaties (CCH) 2819-23T, Note No. 51 submitted by the United Kingdom to the Department of State (March 25, 1980).

<sup>20</sup> Demarche of the Member States of the European Communities to the U.S. Department of State: March 19, 1980; October 30,

already done to the harmonious development of economic relations."<sup>21</sup>

United States Secretary of State George P. Shultz in his January 30, 1986 letter to the Governor of California summarized the international expressions of offense over the use of WWCR:

The worldwide unitary issue has seriously complicated our economic relations with many of our closest allies. During my tenure as Secretary of State, this has been a difficult and long-standing issue. The Department of State has received diplomatic notes complaining about state use of the worldwide unitary method of taxation from virtually every developed country in the world. The unitary issue has been partially responsible for stalling some bilateral tax treaty negotiations.

Most seriously, the U.K. Parliament, in July, 1985, unanimously adopted anti-unitary retaliatory legislation permitting the U.K. government to deny, on a unilateral basis and retroactive to April, 1985, a very valuable benefit of the U.S.-U.K. treaty for U.S. corporations operating in worldwide unitary states.

The United States is clearly prevented from speaking with one voice on foreign commerce due to California's violation of the Federal Government's established AL/SA policy.<sup>22</sup>

1981); June 29, 1982; August 1, 1983; September 23, 1983; December 20, 1984; August 8, 1985; August 30, 1985; June 30, 1989.

<sup>21</sup> Joint Diplomatic Note from the Embassy of Belgium to the Department of State, on behalf of Australia, Austria, Belgium, Canada, Denmark, the European Commission, Federal Republic of Germany, France, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, United Kingdom and Switzerland (January 25, 1984).

<sup>22</sup> Brief *Amicus Curiae* of the United States, Civil Action No. 84-C-8906 United States District Court for the Northern District of Illinois, Eastern Division, p. 15, 17.

The Seventh Circuit Court of Appeals found that WWCR's propensity to penalize foreign ownership of American subsidiaries, its "potential to disfavor a particular mode of foreign participation in the American economy," provided the strongest argument for standing.<sup>23</sup> The Court of Appeals decided that "potential for constitutionally significant offenses is sufficient to create standing."<sup>24</sup> The burdens resulting from WWCR are on foreign commerce, implicating the United States' foreign policy and preventing it from speaking with one voice, thereby satisfying this Court's tests for determining a state tax on foreign commerce unconstitutional.

The elements necessary to result in a determination by this Court that a state tax upon foreign commerce are unconstitutional clearly can be raised only in a foreign commerce challenge. Because the burdens ultimately fall upon the foreign parent corporation, it must have standing to object, just as the foreign corporations in *Japan Line* had standing to test the constitutionality of the state tax under which they were burdened.

It is the directly affected foreign parent corporation that can raise those issues and not its domestic subsidiary. California admits that Respondents have no access to California courts or administrative relief.<sup>25</sup> As the Court of Appeals pointed out, there can be no claim that "a plain, speedy and efficient remedy may be had in the courts of such State."<sup>26</sup> Therefore, denial of standing in this Court would be tantamount to a denial of justice.

The burdens imposed on Alcan are not merely due to its "shareholder" status. Canada and other trading part-

<sup>23</sup> *Alcan Aluminium Ltd. and Imperial Chemical Industries PLC v. Franchise Tax Board*, 860 F.2d 688 at 697 (7th Cir. 1988).

<sup>24</sup> *Id.*

<sup>25</sup> Brief for Petitioners, p. 42.

<sup>26</sup> *Alcan Aluminium Ltd. and Imperial Chemical Industries PLC v. Franchise Tax Board*, 860 F.2d 688 at 698 (7th Cir. 1988).

ners of the United States would have no ground for offense, or retaliation, if California's use of WWCR only reached domestic American corporations. It is the direct adverse impact upon their corporate citizens and their relationships with the United States which causes their offense. Put another way, California's persistent use of WWCR with its direct burdens on foreign commerce, is equivalent to California asserting federal, rather than local jurisdiction.

That foreign parent corporations directly burdened by California's application of WWCR have standing should be strengthened by considerations of international law and comity. This Court has consistently referred to the doctrine of comity<sup>27</sup> among nations. In *Japan Line*, this Court explained that "A State may not tell the United States or Canada how to run their foreign policies"<sup>28</sup> and made it clear that:

California, by its unilateral act, cannot be permitted to place these impediments before this Nation's conduct of its foreign relations and its foreign trade.<sup>29</sup>

### CONCLUSION

In accordance with internationally accepted principles of taxation, the United States, Canada and other nations do not apply WWCR and do not tax foreign corporations solely because they are shareholders of domestic subsidiaries. No political subdivisions of Canada (provinces) apply WWCR since they espouse at the local taxing level the established international practice of AL/SA which is also embodied in Canada's tax treaties. Forty-six of the United States do not use WWCR. California's application of WWCR burdens foreign commerce and affects

<sup>27</sup> *Restatement Third, The Foreign Relations Law of the United States*, Section 403 *et seq.*

<sup>28</sup> 441 U.S. 434 at 456.

<sup>29</sup> 441 U.S. 434 at 452.

the United States Government's ability to speak with one voice to foreign nations on these matters. Canada believes it would be tantamount to a denial of fundamental judicial remedies to close the courts of the United States to the foreign corporations like Alcan that are directly and adversely impacted by the application of WWCR by California.

The decision of the Seventh Circuit Court of Appeals should be upheld.

Respectfully submitted,

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**BRIEF OF**  
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**CONFEDERATIONS OF EUROPE**  
**AND**  
**ORGANIZATION FOR FAIR TREATMENT OF**  
**INTERNATIONAL INVESTMENT INC.**  
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i

### **QUESTION PRESENTED**

Whether a foreign corporation that is denied standing in California courts to contest a California unitary tax assessment on its income from sources outside the United States has standing in federal court to seek protection from California tax and administrative burdens.

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of the Franchise Tax Board of the State of California; and  
B. M. RARANG, Individually and as Auditor, Chicago Office  
of the Franchise Tax Board of the State of California,  
*Petitioners,*

v.

ALCAN ALUMINIUM LIMITED AND  
IMPERIAL CHEMICAL INDUSTRIES PLC,  
*Respondents.*

---

ON WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS  
FOR THE SEVENTH CIRCUIT.

---

**BRIEF OF  
THE UNION OF INDUSTRIAL AND EMPLOYERS'  
CONFEDERATIONS OF EUROPE  
AND  
ORGANIZATION FOR FAIR TREATMENT OF  
INTERNATIONAL INVESTMENT INC.**

---

**INTEREST OF *AMICI CURIAE***

The Union of Industrial and Employers' Confederations of Europe (Union de Confederations de l'Industrie et des Employeurs d'Europe, known as UNICE) is recognized as official spokesman for European business and industry vis-a-vis European Economic Community and other European institutions. Its member federations are the official represen-

tatives of all sectors of business and industrial activity in their respective countries. UNICE comprises thirty-three member federations from twenty-two European countries, including all countries of the European Economic Community,<sup>1</sup> and of the European Free Trade Association.<sup>2</sup> UNICE's permanent secretariat is located in Brussels, Belgium.

One of the important areas covered by UNICE is the area of international double taxation. UNICE has a direct interest in having this Court decide the issue of standing in favor of the respondents, Alcan Aluminium Limited, a Canadian corporation, and Imperial Chemical Industries PLC, an English corporation. UNICE members are actual or potential investors in the United States. UNICE views California's worldwide unitary method tax as a direct impediment to international commerce and trade as well as to the flow of capital and intellectual property between the United States and nations which UNICE represents. UNICE is particularly concerned with the extraterritorial reach of California's unique method of taxation and the fact that California denies access to its courts to foreign investors within that reach.

The Organization For Fair Treatment Of International Investment Inc. (OFTII) is a Delaware nonprofit corporation with membership comprised of domestic subsidiaries of foreign corporations that do not themselves maintain permanent establishments in the United States.<sup>3</sup> OFTII was organized to represent its members' interests in matters of federal and state taxation and to seek both legislative and judicial

<sup>1</sup> The member nations of the EEC are: Belgium, Denmark, France, Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Portugal, Spain, and the United Kingdom.

<sup>2</sup> The member nations of the EFTA are: Austria, Finland, Iceland, Norway, Sweden, and Switzerland.

<sup>3</sup> OFTII members supporting this brief are: AKZO America, Inc.; Alcan Aluminum Corporation; Allied-Lyons North America Corp.; BASF America Corporation; BATUS Inc.; Beecham, Inc.; Foseco Minsep; Gold Fields American Corp.; Hoechst Celanese Corporation; ICI Americas Inc.; Moët & Hennessy; Nestlé Holdings Inc.; Shell Oil Company; Siemens Capital Corporation; Sony Corporation of America; Thorne EMI (USA), Inc.; Unilever United States; Volkswagen of America, Inc.; Volvo of America Corp.

solutions to problems affecting the economic interests of its members.

OFTII, similarly to UNICE, has a direct interest in the standing issue before this Court. OFTII members bear an increased tax burden under California law because they are treated as "unitary" businesses with their foreign parents and have their foreign parents' foreign incomes included in the domestic corporations' California income tax bases. In the event the foreign parents, who already are denied standing in California courts, are also denied standing in federal courts, the entire burden of contesting unitary tax assessments will fall on the domestic subsidiary corporations, the members of OFTII. Most of these members do not have foreign subsidiaries or foreign source income. They do not possess or have access to the information required to demonstrate the correct California worldwide unitary tax assessed on their parents' incomes. As domestic companies, OFTII members are not in a position to invoke the protection of the Federal Government's foreign commerce policies and international treaty commitments.

## SUMMARY OF ARGUMENT

California's worldwide unitary tax method violates international practice and prevents the United States Federal Government from "speaking with one voice" in foreign commercial relations. Imposition of unitary taxes on the foreign revenue of foreign based multinationals interferes with the protection of investments and protection from double taxation and compliance burdens offered to foreign businesses by the international tax treaty network of which the United States is an integral part.

The respondents, foreign parents of subsidiaries operating in California, are themselves classified as "taxpayers" under California law. Yet California does not provide access to its courts to foreign parent companies who actually must bear the burdens of unitary double taxation and compliance. These respondents now seek to bring their cases before the

United States Federal Courts. Federal law grants this right in the absence of a "plain, speedy, and efficient" remedy in California. In recognition of the lack of a California state remedy, the Seventh Circuit Court of Appeals ordered these cases to go back to the District Court for decision on whether California's unitary method in fact violates the United States Constitution and foreign commercial policy established by the Federal Government. Because these foreign parents are the real parties in interest but are without recourse under California law, the Court of Appeals decision should be affirmed.

### ARGUMENT

**CALIFORNIA'S UNITARY TAX IS A DIRECT BURDEN ON FOREIGN COMMERCE AND FOREIGN BUSINESS ENTITIES. THIS SHOULD GIVE SUCH ENTITIES STANDING TO CHALLENGE IMPOSITION OF THESE BURDENS.**

#### A. CALIFORNIA'S VIOLATION OF INTERNATIONAL STANDARDS.

California assesses income taxes based on the worldwide income of multi-national business groups whether the parent companies are foreign or domestic. California is a large and important segment of the economy of the world as well as the foreign commerce of the United States. Because California is not an independent nation, there is no opportunity for foreign countries to negotiate with California for a mutually agreeable means of avoiding double taxation and imposition of unfair administrative and decisional burdens on their own nationals. This prerogative lies solely with the United States Federal Government.

The United States Federal Government has promoted and entered into a series of tax treaties and other international accords that employ the "arm's length" method of income taxation.<sup>4</sup> The international arm's length method recognizes

<sup>4</sup> These United States Tax treaties are in place with all of the EEC and EFTA countries as well as with many other nations, including Australia, Canada, Israel, Japan, and the Soviet Union.

separate identities of subsidiary companies. The arm's length method treats transactions among related companies across national borders as though the parties were unrelated. The fiscal authorities of each country are responsible for ensuring that correct accounting and pricing practices are observed within their respective national boundaries in order to prevent tax avoidance and shifting of income. Each country applies its own accounting principles to this end. The United States Internal Revenue Service, itself, has acquired an international reputation as a diligent and militant enforcer of the arm's length method. The arm's length method is accepted and employed by all of the members of the EEC and EFTA, as well as by Australia, Canada, Korea, Republic of China, and Japan. It is the undisputed international standard. Except for California, *amici* are unaware of any jurisdiction that does not apply the arm's length method to international transactions involving foreign nationals. *Amici* are aware there are three other states, Alaska, Montana, and North Dakota, that make use of the worldwide "unitary" method. Alaska, however, appears to apply the worldwide unitary method only to oil companies. Montana does not apply the worldwide unitary method to foreign based multinationals and the application by North Dakota is outside the experience of *amici*. *Amici* do not know whether the courts of Alaska and North Dakota are closed, as are California courts, to foreign parents of domestic subsidiaries in worldwide unitary tax cases.

One of the principal features of the internationally accepted method to provide for the avoidance of double taxation is to grant country of domicile tax credits to parent companies so as to prevent double taxation of income earned abroad by subsidiaries. See United Nations Model Double Taxation Convention Between Developed and Developing Countries, U.N. Doc. ST/WSA/102 (1977); U.S. Treasury Model Income Tax Treaty, June 16, 1981, 1 CCH Tax Treaties ¶153; Report of the OECD Committee on Fiscal Affairs, Model Double Taxation Convention on Income and Capital (1977). International usage recognizes that the country in which income is earned has the highest right to tax such income. The country to which income is repatriated

after having been earned abroad has the right to levy an incremental tax on that income only in the event its tax rate is higher than the source country's tax rate.

California's unitary tax method cannot be made to work together with the internationally accepted method to avoid double taxation and, more particularly, with the arm's length method in international commerce. California's method ignores separate corporate identities as well as national boundaries; gives no foreign tax credits; disregards taxation at source; and imposes compliance demands that are impossible to meet. See California Franchise Tax Board Regulations Section 25137-6. There is testimony on public record by California's own expert, Professor John K. Shank of Dartmouth College, that "I don't believe any foreign based multinational would have an accounting system that would enable it to produce a tax return in full technical compliance with California law." The reasons for this, as explained by Professor Shank, are, "one [problem] is the difference between accounting records for management purposes and public reporting purposes versus accounting standards for federal tax purposes. Those are different. And the second even beyond that are the different tax laws, plural, for individual states versus the federal tax laws. There are differences there." *Barclay's Bank International Ltd. v. Franchise Tax Board*, No. 325059 (1986), Superior Court of California, Sacramento County, transcript pp. 865-866, *appeal pending*.

By using the worldwide unitary method that conflicts with international and United States Federal standards, California imposes a substantial and discriminatory burden on multinational business transactions. This is particularly important to a foreign parent company which must either conform to California's tax program or keep its operations out of California. By having any significant operations there, the foreign parent subjects itself and all of its subsidiaries worldwide to double taxation, onerous compliance, and general interference with its fiscal affairs. These are not the results contemplated among nations when the United States Government promoted international free trade after World

War II. The countries of Europe and Asia entered into tax and trade accords with the Federal Government believing that it spoke for the United States. By applying its method of taxation to foreign based businesses, California flatly denies that the Federal Government speaks for California in matters of foreign trade and commerce.

#### B. THE FOREIGN PARENTS' STANDING TO CHALLENGE CALIFORNIA'S PRACTICES.

California law regards a foreign business with a subsidiary establishment in California as a California taxpayer. California Revenue and Taxation Code Sections 25102, 25129, 25133, and 25134. Since, however, compliance and payment is only demanded from the subsidiary, it, alone, becomes the "corporation doing business within the limits of . . . California." California Revenue and Taxation Code Section 23151. By this simple semantical device, California denies the foreign taxpayer access to its courts and administrative process. This is taxation without recourse.

It is clear that California's principal purpose in taking this illogical stance is to prevent the constitutional and foreign commerce issues from being heard in any court, including its own state courts. Having lost in the California trial court in the *Barclay's Bank* case on the constitutional issue of applying unitary tax to foreign businesses, California is even more anxious to avoid any other court deciding that issue pending the appeal of the *Barclay's Bank* case.

California should not be allowed to make arbitrary and singular classifications detrimental to foreign commerce and persons. If the foreign parent is a taxpayer for assessment and compliance, it should also be a taxpayer for bringing suit to contest the taxes assessed. Since California has not provided access to its courts to such taxpayers, it follows that the Tax Injunction Act, 28 U.S.C. § 1341, has no application to this case. Neither should principles of comity and federalism prevent the Federal courts from taking jurisdiction to hear what is essentially a case concerning a challenge to Federal authority by California.

Both the petitioner, California's Franchise Tax Board, and the foreign parent respondents, Alcan Aluminium Ltd. and Imperial Chemical Industries PLC, agree that standing in this case depends upon a showing of direct injury to the party bringing suit. Both the petitioner and the respondents rely upon the same authorities for this proposition, *Simon v. Eastern Kentucky Welfare Rights Organization*, 426 U.S. 26 (1976) and *Valley Forge College v. Americans United*, 454 U.S. 464 (1982). If one accepts the basic premise of the unitary tax method, that a multinational business is interdependent and contributions of value flow equally to and from its affiliated organizations, then it follows that an injury to one part is an injury to the whole. California's contradictory posture in this case may be likened to a tort-feasor who injured a child denying that the child's parents have a cause of action of their own in respect of losing the child's services.

If, indeed, a business is "unitary" as California claims, there can be no distinction for standing purposes between taxing the subsidiary and taxing the parent. There should be no doubt as to the right of the *unitary business* to bring suit in California courts by its parent organization. By pretending that only the subsidiary corporation incurs the tax, California is denying the basic premise of its unitary method. This Court should not permit California to levy a tax on an entire business and then deny the right to the real party in interest, the parent organization which must protect the integrity of the entire business as well as the capital of the individual shareholders of the parent, to contest the tax. It is this unique feature of California's unitary tax method that distinguishes it from all of the cases involving suits by shareholders asserting the interest of their corporations. In the cases of the two foreign parents now before this Court, the real parties in interest are those foreign parents, not their United States subsidiaries who have only a secondary interest.

From a practical, business standpoint, the burdens that arise from an extraterritorial tax assessment create damage to the parent which is not, as such, damage to the subsidiary. This is so because the double taxation without access to the California court threatened by the California method of

taxation, will affect the relative attractiveness to the parent of operating in the United States through a subsidiary. To avoid such a threat, the parent would have to operate (a) through a branch, in which case the parent would have its own right to sue in a California court as in the *Barclay's Bank* case; or (b) through independent dealers and distributors, in which case there would be no California nexus for making tax assessments. These are the choices that the United States Court of Appeals (Seventh Circuit) understood were forced upon the foreign parent respondents in these cases in derogation of Federal foreign commercial policy. *Alcan Aluminium Ltd. and Imperial Chemical Industries PLC v. Franchise Tax Board et al.*, 860 F.2d 688, 697 (7th Cir. 1988). If California is permitted to ignore Federal policy and force different choices upon foreign parent companies, foreign retaliation is clearly invited. The United Kingdom has already embarked upon such retaliation with the enactment of New Clause 27 to the United Kingdom Finance Act of 1985. This measure would penalize United States parent companies with California connections who do business in the United Kingdom.

The real danger in California's tax method is that it may cause international trade barriers that took more than forty years to dismantle to be reinstated. There is nothing except treaties and international usage to prevent other states in federal republics such as Brasil, Canada, or the Federal Republic of Germany, from enacting their own extraterritorial taxes, using totally different apportionment formulas than does California. A labor intensive state will use man hours; a high technology state will use only capital employed or value of intellectual property; a state rich in mineral resources will use extractive values as the measure of apportionment. California has chosen a formula that ensures income distortion in favor of its own economy, a combination of high cost real estate, high wages, and relatively low productivity. Even in interstate commerce within the United States, consumer states may use only a sales factor or else double weight sales in the three factor formula. Cf. *Shell Oil Co. v. Iowa Dept. of Rev.* \_\_\_\_ U.S. \_\_\_\_, 109 S. Ct. 278 (1988) (Where sales was the single factor).

Extraterritorial taxation is an insidious and dangerous impediment to international commerce. Should it proliferate, international trade will be severely damaged. One cannot establish production facilities in foreign countries if it means creating a pipeline into one's domestic accounts and revenues. Whether sanctions take the form of confiscating the income of the foreign operation or sequestering the foreign investment is immaterial. Capital will not be risked if there is little reward for its use and returns on capital are negated by double taxation and large tax compliance costs.

If California wishes to regard multinational businesses as monolithic, unitary, entities, subject worldwide to California law, then California should be made to bear the consequences of that choice. The parent in control itself should be permitted access to California courts. If California denies access to its own courts, then the United States Federal courts have an obligation to protect the treaty framework and foreign commerce policy established by the United States Government. If California does not wish to abide by the logic of its choice of the unitary method, it should then be prepared to accept the arm's length method insofar as foreign multinational corporations are concerned. California's withholding of even handed treatment in these cases is a patent effort to extract revenue from foreign based multinational groups by transforming foreign source income of the groups' foreign members into California revenues. The United States Government and this Supreme Court should not permit California to succeed in this effort. Should widespread foreign retaliation ensue, the result will be not merely double taxation, but such a multiplicity of taxation that foreign investment in the United States and United States investment in foreign nations will suffer. The negative effects on the economy of the United States and the world in the 1930s resulting from foreign retaliation to the Smoot-Hawley Tariff Act, 46 Stat. 590, should not be forgotten.

A final comment is offered on California's argument that the cost of complying with its worldwide unitary tax system falls only upon the subsidiary doing business in California and not the parent company. The detail and type of information

required by Franchise Tax Board Regulation Section 25137-6, make it clear that only the parent company could command this type of information. Since it is also clear that California really doesn't expect it to be produced, the argument made by California that the burden is only on the subsidiary takes on a new and sinister meaning: California's worldwide unitary tax on foreign multinationals isn't an income tax at all! It is a largely arbitrary mulct of foreign business. Since taxpayer records are privileged and income information is not shared among competitors, California feels secure that the discriminatory nature of this mulct will not come to light. This is, in short, taxation based on the time honored principle of "what the traffic will bear" applied arbitrarily and without general standards by which income of taxpayers can be fairly measured.

**CONCLUSION**

The foreign parent cases before this Court should not be dismissed on the issue of standing. These foreign parent company respondents should be given the opportunity, denied them in California courts, to prove the nature and extent of their economic injuries in the United States District Court. If the respondents claims are proven, the standing issue resolves itself and the reach of the Constitution's Commerce Clause on worldwide unitary taxation can be properly considered in context. Federal supremacy and international comity militate in favor of allowing the respondents to go forward with their cases. The decision of the Court of Appeals remanding these cases to the District Court should be sustained.

Respectfully submitted,

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OF EUROPE

ORGANIZATION FOR FAIR TREAT-  
MENT OF INTERNATIONAL  
INVESTMENT INC.

*Amici Curiae*

IN THE  
**Supreme Court of the United States**  
OCTOBER TERM, 1988

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA;  
LEONARD WILSON, Individually and as District Man-  
ager, Chicago Office of the Franchise Tax Board of the  
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*Petitioners,*  
v.

ALCAN ALUMINIUM LIMITED AND  
IMPERIAL CHEMICAL INDUSTRIES, PLC,  
*Respondents.*

On Writ of Certiorari to the United States  
Court of Appeals for the Seventh Circuit

**BRIEF OF THE GOVERNMENT OF THE  
UNITED KINGDOM AS AMICUS CURIAE  
SUPPORTING RESPONDENTS**

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IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1988

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No. 88-1400

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FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA;  
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and as Auditor, Chicago Office of the Franchise Tax  
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*Petitioners,*  
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On Writ of Certiorari to the United States  
Court of Appeals for the Seventh Circuit

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BRIEF OF THE GOVERNMENT OF THE  
UNITED KINGDOM AS AMICUS CURIAE  
SUPPORTING RESPONDENTS

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**INTEREST OF AMICUS CURIAE**

The United Kingdom and the United States are allies and major trading partners. The United Kingdom is the largest investor in the United States and the second largest recipient of U.S. direct foreign investment. A major portion of British investment in the United States is by United Kingdom corporations. The issue before this

Court, whether foreign parent corporations have standing to challenge Petitioners' application of worldwide combined reporting ("WWCR") in Federal court, is of general and specific concern to the Government of the United Kingdom ("the United Kingdom"). The Income Tax Convention with the United Kingdom of Great Britain, and Northern Ireland ("the Treaty") prohibits the use of WWCR by either country. Nevertheless, Petitioners have applied WWCR, thereby disrupting the trading and investment relations between the two countries.

Respondent Imperial Chemical Industries, PLC ("ICI") is a United Kingdom corporation. Like numerous other United Kingdom corporate citizens, ICI does not have a permanent establishment and does not conduct business in the United States. It has numerous subsidiary corporations which conduct business throughout the world, including United States subsidiaries with extensive business operations in the United States. When Petitioners, through their application of WWCR, include the income and apportionment factors of a United Kingdom parent corporation, like ICI, and all of its overseas subsidiaries in the tax base of the American subsidiary, the United Kingdom corporation is directly and adversely burdened. If Petitioners prevail here, there is no forum in which United Kingdom corporations can question Petitioners' application of WWCR and seek relief from the burdens it imposes. The United Kingdom hereby submits this brief *amicus curiae* in support of Respondents.<sup>1</sup>

### SUMMARY OF ARGUMENT

There is only one internationally accepted method of corporate tax allocation among countries and that is the arm's length/separate accounting method ("AL/SA"). AL/SA is used by the United Kingdom and the United States and every other major trading nation. Its use is

<sup>1</sup> Petitioners and Respondents have consented to the filing of this brief *amicus curiae* in letters filed with the Clerk of this Court.

required by every double tax treaty to which the United States is a party and is codified in the Internal Revenue Code. Under AL/SA, income of a foreign corporation is not subject to tax solely by virtue of its being a shareholder of a subsidiary in the taxing jurisdiction.

Petitioners' use of WWCR contradicts international tax policy. The extraterritorial effects of Petitioners' use of WWCR has offended the trading partners of the United States, damaged business relations between the United Kingdom and the United States and finally forced the United Kingdom to enact retaliatory legislation.

United Kingdom and other foreign parent corporations are directly and adversely burdened by Petitioners' application of WWCR. When the Petitioners combine the entire worldwide corporate groups of which Respondents are the foreign parent corporations, solely on the basis that Respondents are shareholders in subsidiaries doing business in California, income which has already been subject to tax in the United Kingdom or other countries of domicile is being doubly taxed by California.

By its very nature, the types of financial information which Petitioners demand relating to Respondents and their foreign subsidiaries can only be satisfied, if at all, by Respondents, not by their American subsidiaries. WWCR's apportionment formula with its extraterritorial reach forces foreign parent corporations like Respondents to have to consider the impacts upon the taxation of their domestic subsidiaries in California when they make decisions in the normal course of business regarding capital investments in other countries and foreign subsidiaries.

The deleterious effects which directly burden Respondents and interfere with their foreign commerce provide standing for Respondents in Federal courts and meet the tests established by this Court to judge the unconstitutionality of state taxes.

## ARGUMENT

- I. The interference in the foreign commerce of United Kingdom corporations and the damaging effect on the business relations between the United Kingdom and the United States resulting from Petitioners' use of worldwide combined reporting is of grave concern to the United Kingdom.

WWCR is not used by the United Kingdom, the United States, or any other country. WWCR is used by only four of the states in the United States that tax corporate income and one of the four states (Montana) does not apply it to foreign based multi-corporate groups. AL/SA is the internationally accepted method of corporate tax assessment. This Court has recognized that WWCR is a "serious divergence" from the internationally accepted AL/SA.<sup>2</sup>

No country under AL/SA subjects the income of foreign corporations or its foreign subsidiaries to tax merely because the foreign corporations are shareholders or the parents of a domestic subsidiary. Accordingly, the United States' Internal Revenue Code does not subject the income of a foreign parent corporation and its foreign subsidiaries to tax merely because the foreign parent corporation is a shareholder of an American subsidiary. Also in no case is income apportioned on an arbitrary basis under AL/SA. Subjecting foreign corporations to tax solely because they are shareholders of a California subsidiary and apportioning income on an arbitrary basis is exactly what WWCR does.

Under AL&SA, the income of each corporate member of a corporate group is computed by separate accounting on the basis that each member of the group must deal with each other as if they were wholly separate entities owned by unrelated interests. Both the Mexican Draft

<sup>2</sup> *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983).

and the London Draft of the Model Bilateral Tax Convention on Income and Property of the League of Nations adopted the AL/SA concept in Article IV, as supplemented by Article VI of their Protocols. The Commentary of the Fiscal Committee of the League of Nations states that the method of determining or allocating the profits attributable to a permanent establishment of a foreign enterprise in a country "is known as the method of separate accounting."<sup>3</sup> The intent was expressed:

that each establishment or branch is taxed as if it constituted a distinct independent enterprise and the profits of the establishment are assessed independently of the results of the business done elsewhere.<sup>4</sup>

In July 1979, the Council of the Organization for Economic Cooperation and Development ("OECD"), of which the United States is a member, reaffirmed the recommendation for the use of AL/SA rather than WWCR.<sup>5</sup> The use of AL/SA, not WWCR, is required by the Treaty; all of the double taxation treaties to which the United States' other major trading partners, such as Canada and Australia, Belgium, Denmark, France, Federal Republic of Germany, Greece, Japan, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and Switzerland are signatories; and the model treaties of the United States, OECD, the United Nations.<sup>6</sup>

<sup>3</sup> The Commentary of the Fiscal Committee of the League of Nations 18 (Nov. 1946).

<sup>4</sup> *Id.*

<sup>5</sup> *Transfer Pricing and Multinational Enterprises*, Report of the OECD Committee on Fiscal Affairs (1979).

<sup>6</sup> Report of the OECD Committee on Fiscal Affairs, Model Double Taxation Convention for Income and on Capital, arts. 5(7), 7(2), 9(1) (1977); United Nations Model Double Taxation Convention Between Developed and Developing Countries, arts. 5(8), 7(2), 9(1), U.N. Doc. ST/WSA/102 (1980); U.S. Treasury Depart-

The requirement for AL/SA has been contained in every tax treaty to which the United States has been a party since the first such treaty signed with France on April 27, 1932.<sup>7</sup> That requirement was in turn taken from the predecessor to Internal Revenue Code § 482, first adopted by Congress in the Revenue Act of 1928. The fundamental principle contained in § 482 is that income is to be determined on a separate accounting basis governed by the requirement that all intercompany dealings between parties must meet the arm's length standard.<sup>8</sup>

WWCR rejects the international corporate taxation principles of AL/SA. Petitioners' using WWCR treat separate corporations—foreign and domestic—that are part of a multi-corporate group as one, and subject all the worldwide income of the international corporate group to tax as one “unitary” corporation. Petitioners apportion the group's combined income between California and the rest of the world on the basis of an arbitrary formula composed of the ratio of payroll, sales, and property of the combined corporate group in California compared

ment's Model Income Tax Treaty of June 16, 1981, arts. 5(7), 7(2), 9(1), I Tax Treaties (CCH) 153.

All of the U.S. treaties for the prevention of double taxation contain an absolute prohibition on U.S. taxation of the profits of a foreign corporation which does not have a permanent establishment in the U.S. The following language from Article 7 of the OECD model convention exemplifies this prohibition:

The profits of an enterprise of a Contracting State shall be taxable only in that state unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein.

Article 9 of the OECD model convention, the counterpart to Internal Revenue Code § 482, provides that dealings between related parties may be placed upon an arm's length, independent enterprise basis.

<sup>7</sup> Article IV, TS 885, 49 Stat. 3145.

<sup>8</sup> 26 U.S.C. § 482.

to the world. Moreover, Petitioners combine the income without regard to whether such income is taxable under the Internal Revenue Code or applicable treaty, and without regard to the fact that income has been attributed to and taxed to foreign jurisdictions, under long standing and well recognized procedures established in international law.

The United Kingdom has repeatedly objected to the extra-territorial results of WWCR and was forced to enact retaliatory legislation. The instruments of ratification for the Treaty, exchanged in Washington, D.C. on March 25, 1980, included Diplomatic Note No. 51 emphasizing:

Her Majesty's Government is convinced that the unitary basis of taxation with combined reporting, particularly as applied to the international field is entirely unsatisfactory.

It is the view of Her Majesty's Government that the unitary basis, which is not a practical alternative to the ‘arm's length’ basis, could undo the important and patient international work that has been achieved in regulating international tax practices. . . .<sup>9</sup>

On July 12, 1983, the Chancellor of the Exchequer wrote to the Secretary of the Treasury of the United States, Donald T. Regan, that the United Kingdom was: “keen for the matter to be resolved . . . before harm is done between our two countries.” In September 1983, The Prime Minister, Margaret Thatcher, warned the Federal Government: “We might be under very severe pressure to take retaliatory action.”<sup>10</sup> Frustration with the continued use of WWCR led 296 Members of the

<sup>9</sup> Note No. 51 Submitted by the United Kingdom to the Department of State (March 25, 1980).

<sup>10</sup> House of Commons Official Report, *Parliamentary Debates*, (Hansard) 1022 (9 July 1985) (statement of Michael Grylls).

House of Commons to support in April 1984 early day motion number 202 calling for retaliatory measures to be included in the United Kingdom's 1984 Finance Bill.<sup>11</sup> The United Kingdom felt it premature to retaliate at that time.<sup>12</sup>

With the support of over 250 Members, a retaliatory amendment to the 1985 Finance Bill was introduced in the House of Commons and debated and accepted on July 9, 1985.<sup>13</sup> During the debate, John Moore, Financial Secretary to the Treasury, on behalf of the United Kingdom endorsed the statements that the entire House of Commons:

... felt frustration that a solution to the problem had so long been delayed;

and acknowledged:

... that the time had come for Parliament to take legislative action to register the United Kingdom's determination that a solution is achieved in the United States.<sup>14</sup>

The amendment [enacted as Section 54 of and Schedule 13 to the 1985 Finance Act] gave the United Kingdom power to retaliate for the use of WWCR by withdrawing from American corporations incorporated in California or having their principal place of business there, the right to claim shareholders' tax credit in respect of dividends paid to them by their United Kingdom subsidiaries.<sup>15</sup>

<sup>11</sup> Order Papers—House of Commons.

<sup>12</sup> House of Commons Official Report, *Parliamentary Debates*, (Hansard) 1021 (9 July 1985) (statement of Michael Grylls).

<sup>13</sup> House of Commons Official Report, *Parliamentary Debates*, (Hansard) 1016-1037 (9 July 1985).

<sup>14</sup> House of Commons Official Report, *Parliamentary Debates*, (Hansard) 1034 (9 July 1985) (statement of John Moore).

<sup>15</sup> House of Commons Official Report, *Parliamentary Debates*, (Hansard) 1014-1018 (9 July 1985).

## II. When worldwide combined reporting is applied to foreign corporations with American subsidiaries, the foreign corporation is directly, necessarily and adversely effected.

Petitioners depict the United Kingdom parent corporation, ICI, as a mere "shareholder" that is not directly injured by the application of WWCR.<sup>16</sup> They contend that the resulting tax is not being levied on ICI or its overseas subsidiaries, but only on the American subsidiary doing business in California. From this erroneous premise they conclude that only the in-state subsidiary corporation is affected by the tax and has the standing to challenge its imposition.

The fault in this line of reasoning is obvious. The basis on which the Petitioners compute the tax is the income of the unitized business group, including the out-of-state members. Petitioners' portrayal cannot disguise the fact that to demand extensive information about, and to assess the collection of tax on, the income of foreign corporate members of the multi-corporate group including the Respondents substantially impacts administratively and economically on the foreign corporate parents.

The arithmetic results of applying WWCR also belie Petitioners' argument that WWCR does not tax foreign source income of the foreign parents and foreign subsidiaries of the subsidiary in California. Petitioners in effect require a consolidated income tax return and subject to tax the income earned by foreign members of the international corporate group without giving any relief for foreign tax. In other words, Petitioners have extended the state of California's taxing jurisdiction to bring into its tax net income over which foreign nations will have exercised their priority taxing rights under the normal AL/SA arrangements and treaties. As the United Kingdom has previously made clear:

<sup>16</sup> Brief for the Petitioners, p. 16.

The element of double counting this involves can and does lead to multinational groups being taxed on more than 100 per cent of their income.<sup>17</sup>

Petitioners use the same portrayal to describe the extensive detailed demands they make for information on the operations of the foreign based worldwide corporate group as being "only addressed" to the American subsidiary and allege that the foreign parent corporation will suffer no direct harm if it does not reply.<sup>18</sup> There is no need to repeat the explanation contained in Respondents' briefs of the depth and breadth of those information demands. However, it is obvious that information of the detail and extent regarding the whole worldwide corporate group could not reasonably be expected to be kept by any subsidiary, especially when under the internationally accepted AL/SA, foreign corporations are not subject to tax in the United States on their foreign source income.

If the foreign parent is unable or chooses not to comply with Petitioners' demands for worldwide information it is directly penalized because arbitrary assumptions will be made based on annual reports, for example, which will increase the tax that would otherwise be payable by the American subsidiary under WWCR. The increment attributable to the foreign parent corporation's refusal to supply information is in reality a tax on it to force its compliance. Conversely, if the foreign parent corporation can and does comply, the costs to it may exceed the California tax asserted by Petitioners, as explained in Respondents' briefs.

Federal law requires that domestic subsidiaries of foreign parents provide information only with respect to

<sup>17</sup> Paper Submitted by the Government of the United Kingdom Before the United States Treasury Working Group on Worldwide Unitary Taxation, pp. 11-12.

<sup>18</sup> Brief for the Petitioners, p. 38.

those foreign affiliates that had a "transaction with" the reporting domestic corporation. The information that must be furnished in those cases is limited to readily available information regarding the foreign affiliate and the transactions conducted with it.<sup>19</sup> Thus Petitioners here are seeking worldwide financial data that goes far beyond the limited transactional data that must be furnished to comply with Federal law. The United Kingdom believes an intolerable burden is imposed on foreign commerce to obtain and deliver to Petitioners such detailed financial data, stated in United States dollar terms, for scores of worldwide subsidiaries that do no business in California, or elsewhere in the United States, and have no business contacts with the U.S. subsidiary that does do business there.

Petitioners portray the compliance burden they impose on foreign parent corporations to deliver the detailed information on the worldwide corporate group, which only they as parent corporations, if anyone, can prepare at great cost, as information which "they deem essential to a fairer calculation of taxes assessed against their subsidiaries."<sup>20</sup> Petitioners' brief reveals the contradiction inherent in that characterization. For purposes of reporting under WWCR, the entire worldwide corporate group, of which Respondents in this instance are the parent corporations, is the "taxpayer."<sup>21</sup> For purposes of tax collection and ability to contest such taxes in California state courts, only the California subsidiary is the "taxpayer."<sup>22</sup> Petitioners describe the latter definition of "taxpayer" as the "California taxpayer in the tradi-

<sup>19</sup> Internal Revenue Code of 1986, as amended: 26 U.S.C. § 6038A.

<sup>20</sup> Brief for the Petitioners, p. 39.

<sup>21</sup> Cal. Rev. & Tax. Code § 25102.

<sup>22</sup> Cal. Rev. & Tax. Code § 23151.

tional sense of the party actually subject to state taxation.”<sup>23</sup>

Under the internationally accepted traditional definition of taxpayer, taxing authorities would not require worldwide information about the foreign parent or foreign subsidiaries of a corporation in their jurisdiction simply because the foreign parent corporation owned stock in a domestic subsidiary. Similarly, under the internationally accepted traditional definition of taxpayer, that subsidiary would not have its tax computed based upon the payroll, property and sales of the entire worldwide corporate group. Obviously, it is the foreign parent corporation which directly bears the burden of Petitioners’ application of WWCR.

The Seventh Circuit Court of Appeals recognized that the choices about the manner in which international trade is conducted are “primarily the parents’ choices” and that the injury to the foreign parents caused by the distortion of these choices which result from Petitioners’ use of WWCR also can not be dismissed as “indirect and derivative.”<sup>24</sup> Under the internationally accepted AL/SA, a foreign parent corporation does not have to consider the impact upon its own domestic tax base or the tax base of its nonconcerned subsidiaries when making decisions with respect to changing capital investments in other countries. However, when a foreign parent corporation makes changes in capital investment overseas, the worldwide application of the WWCR apportionment formula forces it to take into account the impact upon the California tax base. The extraterritorial effects of Petitioners’ use of WWCR hampers rather than promotes economic efficiency, distorting investment patterns and inhibiting trade throughout the world.

<sup>23</sup> Brief of Petitioners, p. 40.

<sup>24</sup> *Alcan Aluminium Ltd. and Imperial Chemical Industries PLC v. Franchise Tax Board*, 860 F.2d 688 at 698 (7th Cir. 1988).

### **III. The Tax Injunction Act does not restrict the right of foreign corporations to contest in Federal court Petitioners’ use of worldwide combined reporting.**

Petitioners concede that California’s administrative and judicial remedies are available only to the subsidiaries and not their foreign parent corporations.<sup>25</sup> They would compound the direct, necessary and adverse economic and administrative impacts of WWCR upon foreign corporations by depriving them of access to Federal courts under the Tax Injunction Act. 28. U.S.C. § 1341. The Seventh Circuit Court of Appeals held that the Tax Injunction Act is inapplicable here, as a plain, speedy and effective remedy is not available to Respondents in California.<sup>26</sup>

As discussed above, the United States and the vast majority of states in the United States do not use WWCR. In fact, how Petitioners apply WWCR has little relevance to most states.<sup>27</sup> Therefore, the contention that the upholding of the Seventh Circuit opinion will somehow open the floodgates for foreign corporations to contest the taxing practices of other states in state or Federal courts is groundless.

### **IV. The direct, inherent, and adverse impacts of Petitioners’ use of worldwide combined reporting which provide standing for foreign corporations to contest it in Federal courts, also prevent the United States Federal Government from speaking with one voice in matters of international trade.**

The direct burdens on foreign corporations, the interference with their foreign commerce, and the offense to the United States’ trading partners imposed by Peti-

<sup>25</sup> Brief for the Petitioners, p. 42.

<sup>26</sup> *Alcan Aluminium Ltd. and Imperial Chemical Industries PLC v. Franchise Tax Board*, 860 F.2d at 698 (7th Cir. 1988).

<sup>27</sup> Brief of *Amici Curiae* in Support of the Petitioners by the State of Idaho and Several Other States, p. 1.

tioners' use of WWCR not only creates standing for foreign parent corporations, but also meets this Court's tests to determine the unconstitutionality of state taxes: its use is at variance with federal policy and has implicated foreign policy issues which must be left to the Federal government.<sup>28</sup>

These tests confirm that California may not act as a sovereign nation in the international realm and tax the income of multinational enterprises under an aberrant and contradictory system which interferes with the Federal Government's ability to speak with one voice and which, as seen above, results in double taxation. This case, as opposed to *Container*, involves a foreign parent corporation with a domestic subsidiary. Here there is: (1) an "automatic asymmetry" between Petitioners' use of WWCR and the acknowledged international tax structure; (2) the tax is imposed on a foreign corporation and its domestic subsidiary; and (3) it is a matter of international concern because the United Kingdom and other nations are interested in insuring equitable taxation of their corporations.

That Petitioners' use of WWCR prevents the United States from speaking in one voice has also been clearly established. The Executive Branch of the Federal Government has filed an *amicus curiae* brief in this case in support of Respondents which: (1) makes clear that the Federal Government views WWCR as a threat to the United States' foreign policy; and (2) contains statements by the President, the Secretary of the Treasury and the Secretary of State that the taxation policy of the United States for multinational corporations is AL/SA.<sup>29</sup>

<sup>28</sup> *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979).

<sup>29</sup> Brief *Amicus Curiae* of the United States, Civil Action No. 84-C-8906 United States District Court for the Northern District of Illinois, Eastern Division.

## CONCLUSION

This case brings to this Court a matter which it has previously specifically not addressed—the significance of a foreign parent corporation and its domestic subsidiary in assessing the unconstitutionality of Petitioners' use of WWCR. The United Kingdom is anxious to have that issue resolved before more harm is done to United Kingdom corporations and to United Kingdom—United States relations. The United Kingdom believes this Court would not have left the issue unresolved in *Container* if it had any doubt that foreign parent corporations have standing to bring the issue before it. The disruptions that have been caused by Petitioners' insistence upon the use of WWCR will only increase if foreign parent corporations, like Respondents, are deprived of their standing which the Seventh Circuit Court of Appeals upheld.

For these reasons, the decision of the Seventh Circuit Court of Appeals should be affirmed.

Respectfully submitted,

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IN THE  
**Supreme Court of the United States**  
OCTOBER TERM, 1989

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA;  
LEONARD WILSON, Individually and as District Man-  
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State of California; and B.M. RARANG, Individually  
and as Auditor, Chicago Office of the Franchise Tax  
Board of the State of California,

*Petitioners,*  
v.

ALCAN ALUMINIUM LIMITED and  
IMPERIAL CHEMICAL INDUSTRIES, PLC,  
*Respondents.*

On Writ of Certiorari to the United States  
Court of Appeals for the Seventh Circuit

**BRIEF OF THE MEMBER STATES OF THE  
EUROPEAN COMMUNITIES AND THE GOVERNMENTS  
OF AUSTRALIA, JAPAN, AND SWITZERLAND  
AS AMICUS CURIAE SUPPORTING RESPONDENTS**

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IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1989

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No. 88-1400

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**BRIEF OF THE MEMBER STATES OF THE  
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AS AMICUS CURIAE SUPPORTING RESPONDENTS**

---

**INTEREST OF AMICI CURIAE**

The issue before this Court is whether foreign parent corporations, with no permanent establishment in the United States and no access to California's courts and administrative remedies, have standing in Federal courts to contest Petitioners' application of worldwide combined

reporting ("WWCR") to them solely because they are shareholders of subsidiary corporations doing business in California. The determination of that issue is of considerable importance to the twelve member countries of the European Communities: Belgium, Denmark, France, Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Portugal, Spain, and the United Kingdom; and to the Governments of Australia, Japan, and Switzerland (herein "the Fifteen Countries") and to their future economic and commercial relations with the U.S. The Fifteen Countries constitute the United States' main trading partners, accounting for more than one-half of U.S. trade.

The Fifteen Countries have repeatedly expressed their objections to WWCR as:

- (1) contradictory to, and incompatible with, accepted international principles of corporate tax assessment and the purpose of double taxation treaties in force between the Fifteen Countries and the U.S.; and
- (2) an impediment to investment and trade with the U.S.<sup>1</sup>

Corporations of the Fifteen Countries which do not conduct business in California or the United States, but which have subsidiary corporations in California, are adversely affected by Petitioners' use of WWCR. In the guise of taxing operations within the state of California, Petitioners have included in the tax base and apportionment formula not only the income and property, payroll, and sales factors of the U.S. subsidiaries, but also the income and factors for the worldwide operations of all foreign corporations considered to be conducting a unitary business with them. The Fifteen Countries con-

<sup>1</sup> Demarche of the Member States of the European Communities to the U.S. Department of State: March 19, 1980; October 30, 1981; June 29, 1982; August 1, 1983; September 23, 1983; December 20, 1984; August 8, 1985; August 30, 1985.

sider the issues of the constitutionality of Petitioners' application of WWCR to foreign based multi-corporate groups and the standing of foreign parent corporations to contest such application to be inextricably interlinked. The Fifteen Countries hereby submit this brief *amicus curiae* in support of Respondents.<sup>2</sup>

### SUMMARY OF ARGUMENT AND ARGUMENT

The Fifteen Countries endorse the arguments contained in the Summary of Argument and Argument in the *amicus curiae* brief filed herein by the Government of the United Kingdom.

### CONCLUSION

Petitioners impose through WWCR a tax which is flatly inconsistent with Federal and international policy, thereby preventing the Federal Government from speaking with one voice in a field that must be left to the Federal Government. Its implication of U.S. foreign policy is a matter of public record. If foreign parent corporations are not allowed standing to contest the application of WWCR to them, the implications for U.S. foreign policy will intensify. The Fifteen Countries ask that the decision of the Seventh Circuit Court of Appeals be affirmed.

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July 12, 1989

<sup>2</sup> Petitioners and Respondents have consented to the filing of this brief *amicus curiae* in letters filed with the Clerk of this Court.

# In the Supreme Court

OF THE

## United States

OCTOBER TERM, 1989

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA;  
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*Petitioners,*

VS.

ALCAN ALUMINIUM LIMITED and IMPERIAL  
CHEMICAL INDUSTRIES, PLC,  
*Respondents.*

**On Writ of Certiorari To The United States  
Court Of Appeals For The Seventh Circuit**

**BRIEF OF THE COMMITTEE OF LONDON AND  
SCOTTISH BANKERS, AS AMICUS CURIAE,  
IN SUPPORT OF RESPONDENTS**

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No. 88-1400

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**United States**

OCTOBER TERM, 1989

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA;  
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On Writ of Certiorari To The United States  
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BRIEF OF THE COMMITTEE OF LONDON AND  
SCOTTISH BANKERS, AS AMICUS CURIAE,  
IN SUPPORT OF RESPONDENTS

## INTEREST OF AMICUS CURIAE

The Committee of London and Scottish Bankers is the association of the United Kingdom clearing banks.<sup>1</sup> The Committee includes over seventy percent (70%) of the United Kingdom's banking industry. Its members operate throughout the world, directly or through subsidiaries. As a representative of the international banking community of the United Kingdom, the Committee is particularly concerned about the free flow of international trade and commerce and the removal of barriers thereto. The Committee considers a tax system inconsistent with the internationally adopted standard of arm's length/separate entity accounting,<sup>2</sup> such as California's, to constitute such a barrier. Most of the members of the Committee have operated or presently operate in California<sup>3</sup> and are familiar with the California system of worldwide unitary taxation.<sup>4</sup> The consents of the parties to the filing of this amicus brief pursuant to Rule 36 of the Rules of this Court have been filed with the Clerk.

## INTRODUCTION AND SUMMARY OF ARGUMENT

As presented by petitioners, these cases juxtapose issues of standing on the one hand and the Tax Injunction Act<sup>5</sup> and comity

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<sup>1</sup> The members of this committee are Bank of Scotland, Barclays Bank PLC, Lloyds Bank PLC, Midland Bank PLC, National Westminster Bank PLC, Standard Chartered PLC, The Royal Bank of Scotland PLC and Trustee Savings Bank PLC.

<sup>2</sup> This Court has recognized this method as internationally accepted. *See, Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 187 (1983).

<sup>3</sup> Many of the members have protested or are protesting the application of such taxing system on their California operations, and one of the members is presently litigating the constitutionality of the tax in the California court system.

<sup>4</sup> The California system of worldwide combined reporting and formulary apportionment, commonly known as the California unitary tax or the unitary tax is technically not a tax. Amicus will refer to this method throughout this brief as a "taxing system" or the "unitary system."

<sup>5</sup> 28 U.S.C. § 1341.

on the other and bring into conflict policies underlying each. Lurking beneath these procedural issues are the "merits," that is the constitutionality of the California unitary system when applied to foreign owned and controlled multinational corporate groups.

Because these cases come before this Court on such procedural issues, presumably this Court will not reach the merits, i.e., decide that such application of such taxing system is constitutional or unconstitutional.<sup>6</sup> However, for the Court to dismiss these cases as petitioners urge will frustrate some or all of the policies underlying these important procedural doctrines and may inadvertently affect the underlying merits in other cases which do not have the alleged procedural difficulties herein. Amicus believes that the better decision by this Court is to remand these cases to the District Court to permit the respondents to prove their allegations. However, if this Court determines that overriding policy concerns require that the state court have first opportunity to determine the validity of California's taxing system, this Court should remand with instructions to hold these cases until respondents' subsidiaries have the opportunity to present their claims in their refund cases. At that time the District Court can determine if the interests of the respondents have been fully and properly protected and presented in the so called "alternative remedy" which petitioners are urging.

If this Court determines to dismiss these cases based either on the Tax Injunction Act or standing principles, amicus urges the Court to render its decision on as narrow a ground as possible, leaving open opportunities to prove in a proper forum, with a proper record and proper pleadings, the effect and burden of the

<sup>6</sup> Respondent Alcan Aluminium Limited (Alcan) argues that these cases are fully stipulated and this Court is in a position to decide their merits. This is not so. The stipulations of fact are not facts agreed to. The Court will note from the Joint Appendix that there are often assertions of fact to which one or the other of the parties does not agree. A factual determination should be made on these. This Court is not a trial court and should not be placed in a position of deciding what are essentially issues of fact yet unresolved.

California system on both taxpayers and non-taxpayers alike. Not to do so would frustrate the very object which both petitioners and respondents ultimately seek, that is, a full and fair adjudication of the merits on a fully briefed record in a proper forum.<sup>7</sup>

Amicus believes that the issue of "standing" as framed by the petitioners is a misleading one: respondents have alleged direct injury, causation and a protected interest which should be sufficient to meet standing requirements. The more difficult issue is whether the policy concerns animating the Tax Injunction Act override the right of a litigant without a state forum to present its federal question in a federal court. Amicus believes not.

The Tax Injunction Act is a Congressionally designed solution to balance concerns of states with protection of their revenues against the right of a litigant to have its federal claims fully and fairly heard by a court. The balance struck was to bar from the federal district courts litigants seeking to enjoin, restrain or otherwise interfere with the collection or assessment of a state tax unless the state did not provide the litigant with a state court remedy. The parties agree that the respondents, which are not California taxpayers, have no access to the California courts in this matter. Thus, respondents avoid the threshold bar to federal jurisdiction.

Petitioners, however, argue that refund suits by the respondents' subsidiaries are a sufficient state court remedy since respondents' control over, and interests similar to, their subsidiaries should insure that the subsidiaries present the respondents' cases. Both the history of the Act and its language show that the remedy

<sup>7</sup> There is presently pending in the California Court of Appeal after having been tried in the California Superior Court *Barclays Bank International Ltd. v. Franchise Tax Board*, California Court of Appeal, 3rd District, Case No. 3 Civ. C003388 (consolidated with Case No. 3 Civ. C003389). This case, involving both a foreign intermediate parent and its domestic subsidiary, presents the issues reserved by *Container Corp. v. Franchise Tax Board*, e.g., the constitutionality of combined apportionment with respect to state taxation of a domestic corporation with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries. 463 U.S. at 189, n.26; 195, n.32.

should be in the litigant which has the cause. Commonality of interest should not be sufficient to bar a litigant which suffers its own injury. Moreover, petitioners' solution is based on assumptions that the subsidiary can litigate the parent's separate injuries, not only effectively but fully. Those assumptions are speculative. A speculative remedy is not a plain, speedy and efficient remedy within the meaning of the Act. Further, the scope and effectiveness of such an alternate representation are questions of fact which, in fairness, should be determined by the trier of fact prior to any dismissal.

The policy concerns animating the Tax Injunction Act are not subverted by permitting respondents to make their own cases. The State of California is in a unique position to avoid a conflict between such policies underlying the Act and the rights of litigants by giving such litigants access to its courts to present their claims of injury. In the absence of such access, the State should not be heard to complain.

The policy of comity does not bar respondents. Comity, like the policy driving the Tax Injunction Act, is predicated on the assumption that the respondents have access to the state courts—which respondents do not. Moreover, petitioners' (and amici's) contention that anything other than dismissal will bring a flood of litigation into the federal courts is unfounded. The basic contention of the foreign parents, the unconstitutionality of the California system in application to foreign owned unitary groups, is clearly limited to the unique California system which reaches beyond national boundaries and creates the international difficulties. The principle is not one common to interstate tax problems or to the usual taxing system of most of the states.

The California tax system is not a mere accounting methodology, but an aberrant tax system incompatible with the internationally accepted and uniformly employed separate entity/arm's length tax system. The California system, in operation and effect, cannot function without directly involving and implicating non-taxpayers, including foreign parents and their non-United States affiliates. Because California's tax system intrudes into the internationally accepted system for division of income of multinational entities among nations, this intrusion shifts policy considerations

from those of "our federalism" which concern balances between states and the national government to those of "our nation" in its dealings with other nations. It is not appropriate therefore to deny standing on the basis of comity; in fact to do so would violate principles of international comity.

Amicus believes that the standing "issue" as argued by petitioners is a false one. Standing requirements are traditionally satisfied if the litigant alleges a personal injury, caused by the defendant's unlawful conduct, that can be redressed by the remedy sought. There is no question that respondents have met these requirements.

Respondents have alleged that the petitioners' application of its unconstitutional taxing system to compute the tax of the respondents' subsidiaries causes direct injuries to the respondents, including burdensome compliance costs and actual or increased risk of double taxation. These injuries are injuries of the respondents, not of their subsidiaries. The relief sought would redress these.

Petitioners err when they claim that all respondents' injuries are merely derivative of those to their subsidiaries. Respondent Imperial is subject to loss of potential dividend income from its California subsidiary because the United Kingdom denies a credit for the California taxes to the extent these fall on non-California source income as measured under the accepted international standard. It is Imperial which must pay this double tax on its dividend income.

Both respondents face increased risk of or actual double taxation because of their California investments. The California taxing system relies on a worldwide base and may include in such base values which have been already taxed elsewhere in accordance with internationally accepted standards, a result which respondents' domestic competitors do not face when they invest abroad. This harms the respondents' competitive positions.

The California system cannot function without worldwide information—information which is the respondents', not their subsidiaries'. The costs of compiling such information to permit their subsidiaries to comply with California's tax system are initially those of the respondents, not their subsidiaries. Only respondents

have access to the information. Respondents would not have to compile it but for the California system. Petitioners' argument that it is respondents' choice to compile this information, which they could not be forced to produce, is unreasonable. The alternative is having the subsidiary pay a penalty or an unfair tax. Respondents "volunteer" no more than a victim of extortion "volunteers" to make a payment. The argument that respondents could avoid the injury by passing the costs on to their subsidiaries does not affect the existence of direct injury for standing purposes: costs incurred as the result of an improper tax still raise overall costs and create their own disadvantageous effect on respondents' business.

Respondents have an alternate ground for standing. Respondents, as foreign parents operating in international commerce, are squarely within the zone protected by the Foreign Commerce Clause, which ensures the rights of entities to engage in foreign commerce free from unconstitutional burdens. Petitioners' taxing system, in application, injures respondents' own foreign commerce. Such an injury is sufficient to create standing.

Under the guise of concern that the proper party bring the suit, petitioners are seeking to narrow the scope of the suit, to eliminate any issue of injury to foreign parents. The Seventh Circuit found that the respondents' alleged injuries amount to constitutionally cognizable claims. It is the claims of parties not proof of those claims which forms the basis for standing. Respondents have made the necessary claims through their complaints and stipulations. The inquiry should end there.

## ARGUMENT

### I

#### INTRODUCTION

The basic issue in these cases is whether the lower federal courts have jurisdiction to entertain the respondents' challenge to the California taxing system. The respondents, Alcan' Aluminium Limited (Alcan), a Canadian corporation not doing business in the United States, and Imperial Chemical Industries Limited

(Imperial), a United Kingdom company not doing business in the United States, have alleged that the application of the California worldwide unitary tax system to compute the tax of the respondents' subsidiaries results in an unconstitutional burden upon respondents' foreign commerce. Petitioner, the Franchise Tax Board of the State of California,<sup>8</sup> contends that injury to respondents' foreign commerce is not a cognizable injury sufficiently independent of any injury directly caused by the tax on respondents' California subsidiaries so as to confer standing on either respondent in the federal courts. Even if respondents' alleged injury is sufficiently independent, petitioners claim that the lower federal courts are barred from entertaining the action under the principles of either the Tax Injunction Act or those of comity.

Amicus feels that the standing arguments which petitioners raise are more technical and accordingly will first address the issues of the Tax Injunction Act and comity which involve policy concerns.

### II

#### DISMISSAL OF RESPONDENTS' SUITS WILL NOT PRESERVE THE CONGRESSIONALLY DETERMINED BALANCE BETWEEN MINIMIZING CHALLENGES TO STATE TAXES IN THE LOWER FEDERAL COURTS AND PRESERVING A LITIGANT'S FEDERAL CAUSE.

The Tax Injunction Act represents a Congressionally struck balance between interference with a state's taxing authority and finances and preservation of the rights of litigants who have a valid federal cause of action. To bar such litigants from the federal courts, the Act asks very little of the states and something that is entirely within their control—a state court remedy.<sup>9</sup>

<sup>8</sup> The other petitioners are Leonard Wilson, individually and as District Manager, Chicago Office of the Franchise Tax Board of the State of California; and B.M. Rarang, individually and as Auditor, Chicago Office of the Franchise Tax Board of the State of California.

<sup>9</sup> Access to the state court need not even be easy. This Court has approved procedures where the litigant must pay taxes to sue with no

Nevertheless, petitioners would give even less. Under the guise of the policy animating the first part of the Tax Injunction Act and other horrors as yet dimly perceived,<sup>10</sup> petitioners now seek to have this Court bar a litigant which does not have a plain, speedy and efficient remedy at law or in equity in the courts of the state. If the litigant otherwise meets the jurisdictional requirements of the federal courts and if California will not let that litigant into its courts, the Court should not add yet another requirement to jurisdiction which Congress did not. Petitioners' sought after expansion destroys the balance between the concerns of the state and the litigants.

**A. The History of the Tax Injunction Act Demonstrates That Congress Intended to Preserve a Litigant's Day in Court.**

The Tax Injunction Act was enacted in 1937 to prevent litigants who could qualify under the diversity jurisdiction of the federal courts from pursuing injunctive relief against state taxes so long as the litigants had a state court remedy. Congress recognized that the withholding of large sums of money from a state while the litigation proceeded could seriously disrupt state and county finances. Congress also recognized the basic unfairness to a citizen who had to pay his tax in order to raise federal grounds while the federal courts presented to others an alternative forum with injunctive relief. Accordingly, the legislation had two parts. Concern over disruption to state finances and unfairness in availability of forums was addressed by denying jurisdiction to the federal district court to enjoin, suspend or restrain the assessment, levy or collection of a tax under state law, unless the state gave no remedy in its courts. However, a litigant who did not otherwise

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interest if victorious, *Rosewell v. La Salle National Bank*, 450 U.S. 503 (1981); cross state lines to litigate in a presumably unfriendly forum, *Tully v. Griffin, Inc.*, 429 U.S. 68 (1976); exhaust remedies, *Rosewell v. La Salle National Bank*, 450 U.S. at 507-508; and comply with other procedural obstacles, *see generally*, 17 Wright and Moore, *Federal Practice and Procedure*, § 4237 at p. 659.

<sup>10</sup> Both petitioners and amici predict wholesale avoidance of the Tax Injunction Act. Amicus disagrees.

have a state remedy would not be prevented from pursuing his federal remedy:

It should be emphasized that the bill did not take away any equitable right of the taxpayer or *deprive him of his day in court*. Specific provision was made that the suit will not be withdrawn from the jurisdiction of the federal district court *except* where there is a plain, speedy and efficient remedy at law or in equity in the courts of the state. (Emphasis added.)

Senate Judiciary Committee, 75th Congress, First Session, 2 (1937).

Thus, it was clear that the Tax Injunction Act was intended to bar from the federal courts only those litigants who had a choice of both state and federal forums to challenge a state tax, not to deprive a litigant of his only day in court.

**B. The State of California Does Not Provide Respondents with a Plain, Speedy and Efficient Remedy in Its Courts.**

Petitioners do not dispute that respondents have no right to sue in the California courts to challenge the application of worldwide combined reporting.<sup>11</sup> Petitioners, however, contend that respondents have an "alternative state remedy" in refund suits by their subsidiaries. The petitioners urge this Court to adopt a rule that for the first time would use commonality of interest to bar a litigant which has a cognizable and independent injury.<sup>12</sup>

In urging its alternative state remedy, petitioners assume, without basis, that the subsidiaries are in a position to bring the *same* constitutional claims as the parent and that the proof of such claims is identical. Although the parents and the subsidiaries may both allege constitutional violations based upon the California taxing system's interference with the United States' ability to conduct its foreign policy, the nature of the violations created by

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<sup>11</sup> Petitioners' Opening Brief, p. 21.

<sup>12</sup> The question of the jurisdictional bar cannot arise unless the respondents have such an injury.

the application of this taxing system is different for each.<sup>13</sup> The same act may give rise to interference with constitutional rights in different persons.<sup>14</sup> The petitioners cite no authority<sup>15</sup> that this common grievance restricts the right of either aggrieved party (assuming that each party meets the grounds for federal jurisdiction) to pursue its own litigation.

Not only have the Court of Appeal for the Seventh Circuit in its opinion below in these cases and its earlier decision in *Alcan Aluminium Ltd. v. Department of Revenue*, 724 F.2d 1294 (7th Cir. 1984) and the Court of Appeal for the Ninth Circuit in *Capitol Industries-EMI, Inc., v. Bennett*, 681 F.2d 1107 (9th Cir. 1982), *cert. denied*, 459 U.S. 1087 (1982), rejected this argument, but the Court of Appeal for the Ninth Circuit has also rejected a similar contention in *General Motors Corp. v. California State Board of Equalization*, 815 F.2d 1305 (9th Cir. 1987), *cert. denied*, \_\_\_\_ U.S. \_\_\_\_, 108 S.Ct. 1122 (1988). In that case appellees, which were fiduciaries of certain employee welfare benefit plans, were obligated under their contract with Metropolitan Life Insurance Company to reimburse Metropolitan for gross premium taxes. The State Board of Equalization applied the gross premiums tax not only to the premiums which the appellees paid Metropolitan, but also to the benefits appellees paid the employees under their plan. The Court of Appeal rejected the contention that Metropolitan's ability to challenge the tax constituted a plain, speedy and efficient remedy for the appellees:

<sup>13</sup> See part III.

<sup>14</sup> The situation is not unlike that of a mother who sees her minor child hit by a negligent driver. The same act causes harm to her in a way different than the harm to the child. No one would contend that the mother has no right to litigate her own claim.

<sup>15</sup> Because there is none. In fact authority is to the contrary.

It is true that Metropolitan's interests are substantially similar to that of the appellees. *Capitol Industries-EMI, Inc. v. Bennett*, 681 F.2d 1107 (9th Cir.) (EMI 1), *cert. den.* 459 U.S. 1087, 103 S.Ct. 570, 74 L.Ed.2d 932 (1982), squarely holds, however, that a party without state administrative or judicial remedies can maintain a federal action even if a taxpayer with substantially the same interest has state remedies. *Id.* at 1119. The Tax Injunction Act is no bar to appellees' suit.

815 F.2d at 1308.

**C. Whether a Subsidiary Could Effectively Raise All Arguments and Protect All Rights of Its Parent Is Unclear. An Unclear Remedy Is Not a Sufficient Remedy Under the Tax Injunction Act.**

In urging their "alternative state remedy," petitioners allege, without evidence, that respondents' subsidiaries are in a position to bring the *same* constitutional claims as their parents and that proof of the claims of both is indistinguishable. This Court, in its interpretation of the Tax Injunction Act, has always required that the state remedy be plain. An uncertain remedy or a speculative remedy is not sufficient. *Hillsborough Township v. Cromwell*, 326 U.S. 620 (1946); *Spector Motor Service, Inc. v. McLaughlin*, 323 U.S. 101 (1944); *Georgia Railroad & Banking Co. v. Redwine*, 342 U.S. 299 (1952). In *Hillsborough*, *supra*, the New Jersey courts required a taxpayer who had been singled out for discriminatory taxation to proceed against other members of her class to have their taxes increased rather than reduce the taxpayer's assessment. In that case, although there was a state procedure in place, the Court held:

On the basis of that rule it is plain that the state remedy is not adequate to protect respondent's rights under the federal Constitution.

326 U.S. at 624.

An argument that New Jersey might provide some remedy through a discretionary writ which was non-reviewable created "such uncertainty surrounding the adequacy of the state remedy

as to justify the District Court in retaining jurisdiction of the cause." 326 U.S. at 626.

In *Spector Motor, supra*, in a solution which this Court may wish to consider, the Court remanded the case to the district court with directions to hold the case, rather than dismissing it, until the Connecticut courts had an opportunity to resolve other basic state issues.<sup>16</sup>

In the *Redwine* case, *supra*, this Court rejected a suggestion that use of the federal claim *as a defense* in a suit brought by the appellee to recover taxes was hardly a remedy that could be invoked by the appellant.<sup>17</sup>

In the most recent case before this Court construing the phrase, "plain, speedy and efficient remedy," *Rosewell v. LaSalle National Bank, supra*, this Court explored the legislative history and plain language of § 1341, as well as the policy concerns. There was never an issue about the existence of the remedy, only whether the state court remedy met certain minimal *procedural* criteria.<sup>18</sup>

The Court also discussed the "plain meaning" of the terms:

A *procedural* interpretation of the phrase "a plain, speedy and efficient remedy," and the *procedural* sufficiency of Illinois' remedy, are supported further by analysis of the phrase's individual words. According to the 1934 edition

<sup>16</sup> The matter was subsequently decided in *Spector Motor Service, Inc. v. O'Connor*, 340 U.S. 602 (1950), *overruled on other grounds sub nom. Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

<sup>17</sup> *Georgia Railroad & Banking Co. v. Redwine*, 342 U.S. at 303, fn. 11.

<sup>18</sup> The statute required the taxpayer to pay the tax and sue for refund. The state would not pay interest on any refunded amounts. The Court felt that the issue was whether or not the taxpayer had a *mechanism* in place to assert her rights; the mechanism would be the same whether or not interest was paid. Throughout the opinion the emphasis was on full hearing and a judicial determination. Justice Stevens, writing for the dissent, felt that a plain, speedy and efficient remedy also required certain substantive protections.

Webster's New International Dictionary, *plain* means "clear" or "manifest," *speedy* means "quick," *efficient* means "characterized by effective activity," and a *remedy* is "the legal means to recover a right . . . or obtain redress for . . . a wrong." Webster's New International Dictionary of the English Language, 819, 1878, 2106, 2418 (2d ed. 1934) (Footnote omitted.)

While the Court has never addressed the meaning of the word "speedy," it has interpreted the words "plain" and "efficient." Thus, the Court suggested that "uncertainty concerning a state's remedy may make it less than 'plain' under 28 USC § 1341." *Tully v. Griffin, Inc.*, 429 U.S. at 76.

Earlier cases, without making a direct connection to the word "plain," have held that "uncertainty" surrounding a state-court remedy lifts the bar to federal-court jurisdiction. *Hillsborough v. Cromwell*, 326 U.S., at 625-626. (Footnote omitted.)

450 U.S. at 516-517.

In other words, if the Act requires only procedural safeguards, the litigant must have, at minimum, a clear procedure to invoke.<sup>19</sup>

*South Carolina v. Regan*, 465 U.S. 367 (1984), cited by petitioners, would seem to sustain respondents' position, not petitioners'. South Carolina sought this Court's original jurisdiction to review the constitutionality of § 103(j)(1) of the Internal Revenue Code, requiring certain state obligations to be issued in registered rather than in bearer form to qualify for the interest exemption. The Secretary of Treasury resisted the filing on the ground that the action was barred by the Anti-Injunction Act<sup>20</sup> which, with certain exceptions not relevant here, barred all suits for purpose of restraining the assessment or collection of any tax "by any person, whether or not such person is the person against

<sup>19</sup> See also, *Georgia Railroad & Banking Co. v. Redwine*, 342 U.S. 299 (1952).

<sup>20</sup> 26 U.S.C. § 7421(a).

whom such tax was assessed." (Emphasis added.)<sup>21</sup> Since South Carolina was not the taxpayer, the normal administrative and judicial challenges to the tax provided by the federal law would not be available. The Court held that the state had the standing to bring such suit: in spite of the apparent limitation, the circumstances of enactment strongly suggested that Congress intended the Act to bar a suit only in situations in which Congress had provided the aggrieved party with an alternative legal avenue by which to contest the legality of a particular tax.<sup>22</sup>

Not only does the Tax Injunction Act not contain the third party prohibition of the Anti-Injunction Act, it clearly permits suit when the state courts do not provide a forum.

Petitioners' "solution," the creation of an "alternative remedy" in the hands of third parties, is no solution at all. Whether the scope of a subsidiary's litigation is the same as the scope of the parent's is a question of fact which requires a comparison of the nature of the two cases.<sup>23</sup> In fairness, if this Court were to accept

<sup>21</sup> The italicized portion had been added by a 1966 amendment.

<sup>22</sup> Footnote 19 on which petitioners heavily rely was a response to the concerns expressed in Justice O'Connor's dissent that taxpayers would form organizations which as non-taxpayers could avoid the bar of the Anti-Injunction Act. Petitioners have not contended that the foreign parents in these cases were formed for avoidance purposes. In fact, it is the independent business activity of the parent and its non-taxpayer affiliates which creates the problem: if the parent and these affiliates were not operating profitable businesses, the income of which is included in the tax base, no one would care. Moreover, petitioner Franchise Tax Board has often opposed the inclusion of non-profitable affiliates. This Court and other courts have ample means, such as the sham transaction doctrine, to prevent avoidance. However, blanket rules barring litigants which have independent rights but no procedures to assert them directly would raise the difficult issues of due process alluded to by this Court in *South Carolina v. Regan*. See, 465 U.S. at 375-376, 393-395. See also part III, C. (on litigants within the zone of protected interests).

<sup>23</sup> E.g., is the same evidence admissible? Do claims of non-parties face any exhaustion of remedies requirement? Would there be relevancy exceptions to evidence offered in support of the non-taxpayer claims?

petitioners' approach, this Court<sup>24</sup> should review both the cases here and the alternative refund suits to be sure that all rights are preserved. Even this, of course, would be a deviation from earlier precedent. When there is a question of the extent of the remedy, this Court has either permitted the federal litigation to proceed on the basis that the remedy was speculative<sup>25</sup> or remanded the case to the district court to hold until the state aspects of the litigation were completed.<sup>26</sup> The Court has not dismissed the litigation as the petitioners seek.

Under the plain meaning of the Tax Injunction Act, the respondents' remedies in the state court do not exist. The protection of the respondents by their subsidiaries is speculative. The respondents do not have a plain, speedy and efficient remedy.

#### **D. The Policy Underlying the Tax Injunction Act Does Not Bar Respondents' Actions.**

Petitioners' basis for the expansion of the bar seems to be twofold: the strong policy of the Tax Injunction Act against interference with state tax systems and the collection of state taxes, and the alleged, but not explained, contention that such expansion is necessary to prevent "wholesale avoidance of the Tax Injunction Act."

No one seriously disputes that the purpose of the Tax Injunction Act, as this Court has said, is to "limit drastically federal district court jurisdiction to interfere with so important a local concern as the collection of taxes." *Rosewell v. LaSalle National Bank*, *supra*, 450 U.S. at 522. But Congress also "limited the limitation" by requiring that the state provide a plain, speedy and efficient remedy in its courts.<sup>27</sup>

<sup>24</sup> Or the District Court on remand.

<sup>25</sup> *Hillsborough Township v. Cromwell*, 326 U.S. 620 (1946).

<sup>26</sup> See, *Spector Motor Service, Inc. v. McLaughlin*, 323 U.S. at 105-106.

<sup>27</sup> If the sole-purpose of the Act was to prevent any such litigation in the federal courts short of review by this Court, Congress would have ended 28 U.S.C. § 1341 with the words "state taxes."

The courts below have pointed out that the state holds within its own hands the answer to its perceived problem: give the litigant a forum. Petitioners' response to this is only that it would be "disruptive." Petitioners do not explain why. Why would the pressing of its suit by the litigant which has a direct injury be more disruptive to the state, particularly if the constitutional claims are, as the state contends, the same? Contrary to petitioners' urging, would this not promote more efficiency in such litigation?<sup>28</sup> At the same time it would insure that all rights and all parties' concerns could be heard in one forum.

Petitioners also contend that, unless this Court expands the bar of the Tax Injunction Act in the cases herein, states will be faced with a multiplicity of suits in the federal courts in direct derogation of the Act's purposes.<sup>29</sup> Again, the states possess a ready solution: give the litigant its day in their courts.

However, even without such a solution, the states have not indicated how, as a practical matter, the special circumstances of

<sup>28</sup> A particularly apposite example is *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977). In that case, six exchanges were able to join taxpayer members in state court in challenging the constitutionality of a state tax which, by its imposition, diverted business from the exchanges, non-taxpayers. This Court held that the exchanges had rights within the "zone of interests" protected by the Commerce Clause. See also, part III, C hereof.

<sup>29</sup> Contentions that the same arguments could be applied in challenges to interstate commerce are baseless. Respondents allege two injuries, double tax and compliance burdens, which are direct to them. In interstate commerce, the burden of double taxation is probably foreclosed. *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978). Nor are these special compliance burdens likely to be raised in the context of interstate commerce. Any information necessary to determine tax within the United States is already collected for federal tax purposes, so, unlike the additional burden of collecting new information from outside the United States in derogation of the international standards, there are no compliance burdens for foreign parents in addition to those which domestic parents face.

this litigation<sup>30</sup> would permit non-taxpayers to circumvent the limitations of the Tax Injunction Act. First, the courts already have the tools to avoid attempts to evade the strictures of this Act—through sham transaction or similar analysis—where subsidiaries or other corporations are formed solely for the purpose of bringing suit. Second, it is difficult to see how a litigant can raise the type of injury at question here, or any other type of injury, except in the very peculiar circumstances of the California worldwide combined reporting system. Although many states employ the unitary principle, few states have ever employed worldwide combined reporting,<sup>31</sup> and of the few, California is almost alone in pursuing the system to the extent and with the vigor California employs. The system is unique and the problems which it creates are unique.

#### **E. The Principles of Comity Have No Application When the State Provides No Remedy.**

Petitioners also urge that the principle of comity should apply even if the Tax Injunction Act does not. Petitioners rely on *Fair Assessment In Real Estate Association, Inc. v. McNary*, 454 U.S. 100 (1981). Again, this case does not really stand for the proposition which petitioners advance. In *Fair Assessment*, the taxpayers had a plain, adequate and complete state remedy. As this Court said:

<sup>30</sup> See part III, B hereof.

<sup>31</sup> Of the states that have used some kind of unitary principle, only five (Alaska, California, Idaho, North Dakota and Oregon) routinely used true worldwide combination prior to 1983. Rusch and Kennedy, *State Revenues That Would Be Lost By Prohibiting Worldwide Unitary Taxation*, Tax Notes, p. 1035, 1036-1037 (December 19, 1983). Five others (Colorado, Massachusetts, Montana, New Hampshire and Utah) included foreign subsidiaries of U.S. parents, but excluded foreign parents and foreign subsidiaries of foreign parents. *Id.* Currently, all states except Alaska have adopted some form of water's edge legislation limiting worldwide combined reporting. BNA Daily Tax Reports, p. G-2, June 9, 1989 (describing a June 7, 1989 statement of Senator William Roth on the introduction of federal legislation on state unitary taxation).

Such taxpayers must seek protection of their federal rights by state remedies, provided of course that those remedies are plain, adequate, and complete<sup>8</sup> and may ultimately seek reviews of the state decisions in this Court. (Citations omitted.)

The adequacy of available Missouri remedies is not at issue in these cases. The District Court expressly found "that [petitioners] have means to rectify what they consider an unjust situation through the state's own processes," ... and petitioners do not contest this finding. In addition, the Missouri Supreme Court has expressly held that plaintiffs such as petitioners may assert a Section 1983 claim in state court. (Citations omitted.)

454 U.S. at 116.

The Court in footnote 8 referred to in the text above, also pointed out that there was no significant difference for purposes of the principles recognized in these cases between remedies which are: "plain, adequate and complete," as the phrase was used in articulating the doctrine of equitable restraint and those which are plain, speedy and efficient within the meaning of the Tax Injunction Act. The Court specifically referred to the numerous federal decisions treating the adequacy of the state remedies and stated: "[I]t is to that body of law that federal courts should look in seeking to determine the occasions for the comity spoken of today." *Id.*

These cases do not lend themselves to the application of principles of comity.

#### **F. International Comity Creates a Countervailing Policy to Permit the Respondents to Pursue Their Federal Cause.**

The California system, worldwide combined reporting of a so called unitary business, cannot function without directly involving and implicating non-taxpayers.<sup>32</sup> The burdens which this system

<sup>32</sup> *Amici*, Idaho, et al., contend that the nature of California's tax is irrelevant to the questions presented by this Court. On the contrary, the nature of the California method of dividing the taxable income of multinational business is most relevant to the issues before this Court.

creates in seeking to determine California's share of taxable income fall not solely on the taxpayer as taxes paid, as the petitioners would have this Court believe, but also upon the other non-taxpayer members of unitary business, particularly upon the parent, as double taxation and compliance costs incurred solely to permit the parent and related companies to respond to the demands of the California system.<sup>33</sup> California's system reaches out well beyond California—or United States—boundaries to affect economic decisions by the parent on a continuing basis and—where the parent is a foreign parent as are respondents—places such parent at a competitive disadvantage when it invests in California.

The states understandably are quick to rise to a defense of any perceived intrusion into their taxing systems. But the states here are not quick to recognize a counter intrusion which an inconsistent taxing system such as California's makes into the internationally accepted system of dividing income for tax purposes. It is this intrusion which shifts the policy considerations from those of "our federalism," which concerns balance between our states and our national government, to those of "our nation" and its dealings with other nations.<sup>34</sup> It is no secret—and the record in these cases affirms it—that the California tax system has become an international "cause celebre."<sup>35</sup>

The Court of Appeal below recognized this when it referred to "international comity."

Thus, there is a countervailing policy reason not to extend the principles of comity in those circumstances where the issues do not solely involve the relationships between the nation and the states. The concerns of "our nation" must always be supreme.

<sup>33</sup> See part III hereof.

<sup>34</sup> California is one of the largest "nations" in the world in terms of its economy—generally ranked in the top seven world economies—so that it has ample resources to pursue its system. Its intrusion is neither minimal nor indirect.

<sup>35</sup> See, e.g., Joint Appendix, 34 and Exhibits 17-1 to 17-4.

## III

**IN THE GUISE OF STANDING, PETITIONERS ATTEMPT TO PROCURE A PREMATURE RULING ON THE MERITS OF THE CALIFORNIA TAX AS APPLIED TO FOREIGN OWNED AND CONTROLLED UNITARY GROUPS.**

Respondents fit within the four corners of the traditionally recognized requirements for standing. Respondents allege in their complaints (supported by the partially agreed stipulation of facts) an injury personal to them, caused by petitioners' application of worldwide combined reporting to their California subsidiaries. Those allegations are sufficient to confer standing in the federal courts.

Further, respondents fit within the "zone of protected interest" cases which also provide a basis for standing. The Court of Appeal below recognized that the application of an allegedly unconstitutional tax adversely affects respondents' economic interests, an injury sufficient to provide independent standing.

Petitioners' attempts to define away respondents' injury as derivative or non-cognizable are nothing more than attempts to get a premature ruling on the merits. Traditional standing analysis does not reach the merits. The standing issue appears before this Court only because the petitioners refuse to recognize the possibility of merit in respondents' claims and do not wish to provide the respondents with a forum in which to air their grievances.

**A. Respondents Have Made Sufficient Allegations of Injury and Causation for Purposes of Standing.**

Traditional standing rules require no more than that a litigant allege such a personal stake in the outcome of a controversy before the court so as to warrant the litigant's own invocation of federal court jurisdiction and justify the exercise of the court's remedial powers on its behalf. *Warth v. Seldin*, 422 U.S. 490 (1975); *Valley Forge Christian College v. Americans United for Separation of Church & State, Inc.*, 454 U.S. 464 (1982). The injury alleged by the litigant must be fairly traceable to the

defendant's unlawful conduct and be capable of the redress sought by the litigant. *Allen v. Wright*, 468 U.S. 737, 751 (1984).

Respondents satisfy these requirements. Respondents have identified injuries suffered by them directly as foreign parents as the consequence of the alleged unconstitutional application by petitioners of worldwide combined reporting to respondents' California subsidiaries. Respondents allege that the application of worldwide combined reporting by petitioners to compute the tax of their United States subsidiaries is unconstitutional as a violation of the Foreign Commerce Clause.<sup>36</sup> Respondents allege that the California taxing system requires them, as well as their subsidiaries, at substantial cost to them, not to their subsidiaries, to compile information which, to the extent it exists, is their information, not the subsidiaries. The respondents would not have to compile this information *but for* the California tax system. Respondents also allege that they, not their subsidiaries, suffer actual or increased risk of double taxation. This alleged injury is different from, and independent of, any increase in taxes to their California subsidiaries. The Court of Appeal recognized from the respondents' allegations and the stipulations that the California taxing system, in application, impacts adversely upon respondents' economic choices, in derogation of their protected rights under the Foreign Commerce Clause. It is those injuries of which respondents complain and those injuries for which they seek redress. The relief sought by respondents will stop the alleged unconstitutional application of the tax to foreign parent unitary groups.

**B. Respondents' Injuries Are Direct Injuries, Not Those of Their Subsidiaries.**

Petitioners first contend that there is no constitutionally cognizable injury in the parents, only derivative injury of the subsidiary. Petitioners virtually ignore Imperial's claim of double tax by denial of credit. Petitioners recharacterize respondents' general claims of double taxation as claims of wrongful inclusion of the income of the foreign parent in the apportionable income base of

<sup>36</sup> Article I, Section 8, clause 3.

the unitary group. They then argue that any compliance burden asserted by respondents is really that of the subsidiaries. Finally, they argue that the tax is the only cognizable burden—and that tax is on the subsidiary. Even if each injury exists and is cognizable—which petitioners deny—since the injuries are really those of the subsidiaries, the alleged harm reduces the subsidiaries' value: such diminution, argue petitioners, is not a direct injury to the parents, and is insufficient to provide standing under prudential standards.

Petitioners hope, by defining the injuries away, to eliminate the party in the best, and perhaps only,<sup>37</sup> position to claim them. The basic problem with petitioners' approach is that it is not for a defendant to define the injuries of the litigant.

### 1. Imperial's Additional Double Tax Injury Is a Direct Injury.

Although both respondents allege general claims of double taxation,<sup>38</sup> Imperial also contends that risk of double taxation arises from denial of credit against taxes which it must pay in the United Kingdom on dividends from its California subsidiary. The United Kingdom will deny such credit for California taxes on the subsidiary's income if the United Kingdom determines, using the international standard, that such California taxes are measured by income not having a source in California.<sup>39</sup> This is an injury to Imperial since it reduces its net dividends. The cause of the injury

<sup>37</sup> See, subpart E hereafter.

<sup>38</sup> Both respondents allege double taxation of their income caused by the California tax. It is unclear and presumably would await consideration of the underlying evidence whether the double tax complained of is actual double taxation or is simply increased risk of double taxation. Either, as this Court stated in *Japan Line Ltd. v. Los Angeles County*, 441 U.S. 434 (1979), may create constitutionally cognizable competitive disadvantage.

<sup>39</sup> Joint Appendix 19, 57, Ex. 19. The California tax system, of course, is different than and incompatible with the internationally accepted standard of arm's length/separate entity accounting and its attendant rules for the division of income among nations.

is the failure of California to abide by the international standard in determining its tax base. This type of injury clearly does not fall on the subsidiary, but directly on the parent.<sup>40</sup>

### 2. Both Respondents Allege General Double Tax Injury, an Injury Directly That of the Parents.

Understandably, petitioners characterize respondents' general double taxation claims narrowly, in an attempt to fit these within the confines of this Court's opinion last term in *Shell Oil Co. v. Iowa Department of Revenue*, \_\_\_ U.S. \_\_\_, 109 S.Ct. 278 (1989). *Shell* held that inclusion in the apportionable income base of income claimed to be foreign sourced was constitutional under the four part test of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). It did not address the issue of whether double taxation of the income of a foreign unitary group was unconstitutional under the additional two tests applicable when foreign commerce is implicated. *Japan Line Ltd. v. Los Angeles County*, 441 U.S. 434 (1979); *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983).

Here, the question is not whether extraterritorial taxation occurs because of inclusion of certain income within the tax base, but whether double taxation of the international income of the foreign unitary group headed by respondents (i.e., taxing the same values twice) is a constitutionally cognizable claim if proven within the limits of *Japan Line, Limited v. Los Angeles*, *supra* and *Container Corp. v. Franchise Tax Board*, *supra*. Since the facts surrounding such claims are not yet proven, a decision that this injury is not cognizable is premature.<sup>41</sup>

<sup>40</sup> It would also seem to fall clearly within the type of direct injury described by petitioners in their opening brief. See discussion at p. 24 in which actions involving dividends are cited as examples of the exception to the stockholder standing rule.

<sup>41</sup> In addition, even if such "double taxation" does not fall under the first of the two additional *Japan Line* tests, it may still affect the second test.

### 3. Both Respondents Allege Compliance Burdens Falling Directly on Them in Violation of the Foreign Commerce Clause.

This Court has long accepted the principle that, in examining the constitutionality of a tax, it is not only the incidence of the tax that must be examined, but also the tax in its practical operation and effect. *See, e.g., New Energy Co. of Indiana v. Limbach*, 486 U.S. 269 (1988); *American Trucking Assn., Inc. v. Scheiner*, 483 U.S. 266 (1987); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984); *Halliburton Oil Well Cementing Co. v. Riley*, 373 U.S. 64 (1963).

Under California law, to compute its tax, a California taxpayer must determine the *worldwide* income of the unitary business and the *worldwide* factors.<sup>42</sup> Respondents have alleged that they have suffered injury because *they* incur cost and expense in compiling information necessary to compute the tax. The information required by the California tax system, to the extent it exists, clearly must come from the foreign parents and their non-United States affiliates. Respondents contend that the California tax system cannot operate, and more importantly operate fairly, without the gathering of this information.<sup>43</sup>

The only reason for such compilation of information by the foreign parent is to meet the requirements of the California tax system. Petitioners contend that these are only the obligations of the taxpayer, that no demands are made on either of the respondents and

clearly both have been at liberty to decline any requests for information which may have been directed to them by their subsidiaries.

\* \* \*

<sup>42</sup> Joint Appendix, 46-47.

<sup>43</sup> The information is not ordinarily compiled or kept by the taxpayer subsidiaries or even available to them in the normal course of business. For that matter, much of the information would not be compiled by the parent in the normal course. Joint Appendix, 78.

[It is the] respondents' argument that, unless their subsidiaries are to be at the mercy of the California taxing authorities, the parents must establish elaborate systems of accounting to determine the correct California tax liability. What Alcan and Imperial actually are complaining about is the expense of gathering information which *they* deem essential to a fairer calculation of the taxes assessed against their subsidiaries. This again would be an assumed burden undertaken to preserve the value of their stock holdings, not a burden imposed upon them by the taxing authorities.<sup>44</sup>

Petitioners' response reveals the California taxing system as the classic "Catch 22." The system cannot operate without the information. The information is in the hands of respondents. Respondents have the "choice" of incurring cost or seeing their subsidiaries penalized. Therefore, conclude petitioners, there is no burden on respondents. The decision whether to incur the compliance burdens or forego production of information and let the subsidiary suffer an unfair tax or penalties is that of the parent. Either way, the business incurs additional cost (which, of course, makes the business less competitive). A system which creates this type of anti-competitive choice is a clear violation of the Commerce Clause. *See, e.g., Hunt v. Washington State Apple Advertising Commission*, 432 U.S. 333 (1977).

Even if the costs are passed on to respondents' subsidiaries, the costs are initially those of the respondents and constitute direct injury for standing. Petitioners' argument here is similar to that already rejected by this Court in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984).

In that case, Hawaii argued that liquor wholesalers who brought an action in federal court seeking to recover taxes paid under protest pursuant to the Hawaii Liquor Tax Law had no

<sup>44</sup> Petitioners' Opening Brief, p. 39. In the footnote to this text in their brief, the petitioners state that much of the information utilized is already available in published form. However, that information is not in the form of California tax information and, as the stipulations show, it is necessary to convert such information and collect other information, at considerable expense, to respond properly. Joint Appendix, 58, 78.

standing to challenge the tax because they could pass on the tax and thus sustain no injury. After first noting that the wholesalers had to return the tax to the state whether or not the customers paid, this Court stated that, *even if* the tax was completely and successfully passed on, the tax increased the price of the wholesalers' products as compared to the exempted beverages and discriminated against the wholesalers' business. Thus, the wholesalers were surely entitled to litigate "whether the discriminatory tax had an adverse competitive impact on their business" and clearly had standing in the Court to challenge the tax. *Id.* at 468 U.S. 267.

Even if the burdens of worldwide combined reporting are passed on to the respondents' subsidiaries, the respondents must still incur these first, and the increased cost creates a competitive disadvantage to a foreign unitary group which must suffer the offshore effects of the California tax. Like the Hawaiian liquor wholesalers, respondents are entitled to their day in court to prove the discriminatory effect and the anti-competitive impact of the California tax on their business.

**C. Respondents Are Within the Zone of Interests Protected Under the Foreign Commerce Clause. They Have Alleged Sufficient Injury to Their Competitive Interests by Virtue of the Petitioners' Application of Worldwide Combined Reporting to Their Subsidiaries. Such Injury Is Cognizable for Purposes of Standing.**

This Court recognizes standing where a litigant asserts an independent injury, economic or otherwise, as a result of an unconstitutional act to a party with whom the litigant has a business or professional relationship. *See, e.g., Pierce v. Society of Sisters of the Holy Names of Jesus and Mary*, 268 U.S. 510 (1925); *Village of Arlington Heights v. Metropolitan Housing Development Corp.*, 429 U.S. 252 (1977); *Association of Data Processing Service Organizations, Inc. v. Camp*, 397 U.S. 150 (1970). This Court also recognizes standing in representatives or associations on their own behalf, separate and apart from that of their members, where the representative or association asserts injury to itself. *See, e.g., Hunt v. Washington State Apple Advertising Commission, supra* [standing in Washington Apple

Advertising Commission *in its own right* to assert unconstitutionality of a regulatory measure affecting Washington apple growers (its members) where the Commission alleged that its attempt to remedy injury to its members was central to its purpose of protecting and enhancing the Washington marketplace for its growers]; *see also, Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977).

These cases recognize that constitutional guarantees often protect a "zone of interests." If a party fits within those zones of protectable interests and alleges an injury to its own interests caused by constitutional violations affecting another, standing exists.

In *Boston Stock Exchange v. State Tax Commission, supra*, this Court held that six regional stock exchanges had standing to challenge a discriminatory tax because they were in the zone of interests protected under the Commerce Clause. The stock exchanges, located outside of New York, had filed an action in state court against the State Tax Commission of New York and its members, alleging that the transfer tax asserted by New York unconstitutionally discriminated against interstate commerce by imposing a greater tax burden on security transactions involving out-of-state sales than on transactions of the same magnitude involving in-state sales. The State raised the question of the standing of the exchanges to raise the issue. The Court dismissed the argument stating:

Appellants' complaint alleged that a substantial portion of the transactions on their exchanges involved securities that are subject to the New York transfer tax, and that the higher tax on the out-of-state sales of such securities diverted their business from their facilities to exchanges in New York. This diversion was the express purpose of the challenged statute. The allegation establishes that the statute has caused them "injury in fact" and that a case or controversy exists. The Exchanges are asserting their right under the Commerce Clause to engage in interstate commerce free from discriminatory taxes on their business and they allege that the transfer tax indirectly infringes on that right. Thus, they are "arguably within the zone of interests to be protected . . . by

the . . . constitutional guarantee in question." (Citations omitted.)

429 U.S. at 320-21, n.3.<sup>45</sup>

Respondents are clearly within the zone of interest protected by the Foreign Commerce Clause: the alleged injury to their economic interests arises from the application of the California taxing system in violation of the Foreign Commerce Clause. They clearly have standing.

**D. Petitioners' Narrow Definition of Injury Attempts to Reach the Merits<sup>46</sup>**

Standing does not depend on the ultimate adjudication of the merits of the litigants' contention, but rather on the nature and sources of the claims asserted. *Warth v. Seldin*, 422 U.S. at 500.

The California system, using worldwide information, cannot exist without implicating worldwide operations. The "implications" result in real out-of-pocket costs. It is these "offshore implications" which create the injuries as well as make California's tax system unconstitutional.

Petitioners, understandably, would prefer to litigate these cases on narrow grounds. Under the guise of concern over the "party bringing the issue" (standing), they seek to define what it is that the party can litigate. By invoking the policies of the Tax Injunction Act, petitioners have sought to bar from all courts the very parties in the best position to bring before the courts these difficult issues.<sup>47</sup> As this Court has said in *Association of Data*

<sup>45</sup> It is interesting to note that in the *Boston Stock Exchange* case, unlike these cases, the exchanges were able to pursue their remedies in state court. Here, petitioners afford respondents no similar opportunity.

<sup>46</sup> Petitioners ask the Court not to decide the merits. Yet, they spend most of the time arguing the presence and incidence of injuries (i.e., the merits), not the sufficiency of the allegations.

<sup>47</sup> For example, if Imperial cannot bring before the court its double tax issue (credit, etc.) because petitioners contend it is not Imperial's injury but the subsidiaries', is there any assurance that the subsidiaries could raise it in a trial court? Will not petitioners contend that it is not

*Processing Service Organizations, Inc. v. Camp*, *supra*, in reversing the Court of Appeal which had looked to the legal interest of the appellant in denying standing:

The "legal interest" test goes to the merits. The question of standing is different. It concerns, apart from the "case" or "controversy" test, the question whether the interest sought to be protected by the complainant is arguably within the zone of interests to be protected or regulated by the statute or constitutional guarantee in question.

397 U.S. at 153.

Because the California taxing system, in practice and effect, clearly affects more than the taxpayer subsidiaries and because the ultimate issue will be the California taxing system's constitutional or unconstitutional burden on foreign commerce, if there is any doubt that all issues and arguments can be placed before the court in a refund suit by a domestic subsidiary this Court should err on the side of allowing the suits herein.<sup>48</sup>

the subsidiaries' injury and exclude the proposed evidence on relevancy or other evidentiary grounds? *See also* part II hereof.

<sup>48</sup> Or, alternatively, deciding the issues on narrow grounds so as not to indirectly influence or impact the cases currently pending in the state courts.

### CONCLUSION

The California unitary system operates on the theory that California is only "measuring" its tax by the worldwide income of the unitary group. The merits of this position are not before this Court at this time.

Respondents, on the other hand, have alleged that injury from the operation of the system extends beyond their California subsidiaries and that the unconstitutional application of the California system directly injures them. The sufficiency, but not the merits, of these allegations is before this Court.

It is clear that respondents do not have access to the California courts to hear their claims. What is also clear is that the Tax Injunction Act does not, and the underlying principles of that Act or comity should not, prohibit respondents from raising those claims in a federal forum.

Respondents have sufficiently alleged their federal claims. They should be allowed their day in court.

Respectfully submitted,

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